finance
advisor
investment
treasury
transfer
cheque
virtual
profitability
account
service
savings
yield
trust
interest
asset
insurance
economy
professional
community
credit
branch
deposit
security
support
funds
innovation
respect
listening
international
brokerage
manager
cash
convenience
transaction
currency
access
electronic
exchange
reputation
quality
efficiency

ANNUAL REPORT 1998

FORCE

MORE THAN A BANK

BANK

AN ACTIVE FORCE

NATIONAL BANK OF CANADA

Profile of National Bank of Canada

National Bank of Canada is an integrated financial group whose mission is to provide comprehensive financial services to consumers, small and medium-sized enterprises and large corporations in its core market, while offering specialized services to its clients elsewhere in the world.

The National Bank offers a full array of banking services, including all the investment banking services required by large corporations. It is an active player on international capital markets and, through its subsidiaries, is involved in securities brokerage, insurance and wealth management as well as mutual fund and retirement plan management.

Ranking sixth among Canada's chartered banks, the National Bank is the leading banking institution in Quebec and the bank of choice for independent businesses. It has branches in every province of Canada. Through its representative offices, subsidiaries and alliances, it is also represented in the United States, Europe and elsewhere in the world.

Founded in 1859, National Bank of Canada is the product of a series of mergers and acquisitions. Its assets now exceed $70 billion and, together with its subsidiaries, it employs over 17,000 people. The Bank's head office is in Montreal and its shares are listed on the Toronto, Montreal and Vancouver stock exchanges.

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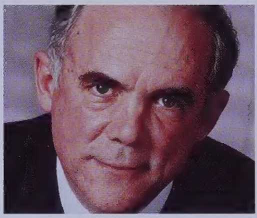
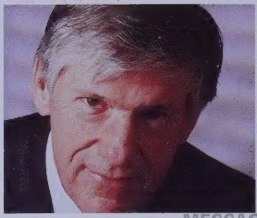
HIGHLIGHTS

	1998	1997	Percentage change 1998/1997
Results of Operations (millions of dollars)			
Net interest income	$ 1,307	$ 1,319	(1)
Other income	1,142	1,056	8
Net income before write-off of goodwill	380	342	11
Net income	316	342	(8)
Financial Ratios			
Return on common shareholders' equity before write-off of goodwill	14.1%	14.0%	
Return on common shareholders' equity	11.6%	14.0%	
Per Common Share			
Net income before write-off of goodwill			
– Basic	$ 2.07	$ 1.86	11
– Fully diluted	2.05	1.84	11
Net income			
– Basic	$ 1.69	$ 1.86	(9)
– Fully diluted	1.67	1.84	(9)
Dividends	0.66	0.575	15
Book value	13.86	13.99	(1)
Stock trading range			
– High	31.25	20.30	
– Low	20.10	13.20	
– Close	23.05	20.15	
Financial Position (1) (millions of dollars)			
Total assets	$70,663	$66,235	7
Loans and bankers' acceptances	49,042	49,532	(1)
Deposits	48,026	43,270	11
Shareholders' equity and bank debentures	3,661	3,829	(4)
Capital ratios – BIS			
– Tier 1	7.7%	8.1%	
– Total	10.7%	11.3%	
Other Information			
Number of common shares at end of year (in thousands)	171,616	170,461	1
Number of common shareholders of record	32,902	34,433	(4)
Number of employees	17,084	16,320	5
Number of branches in Canada	646	637	1
Number of banking machines	747	738	1

(1) The impact of the adjustment to the general allowance for credit risk is explained in Note 25 to the consolidated financial statements on page 71.

André Bérard
Léon Courville
Jean Turmel





MESSAGE TO SHAREHOLDERS

In fiscal 1998, National Bank of Canada turned in a financial performance that not only consolidated the progress made in the past, but also set its course for the future. Decisive steps were taken towards attaining the Bank's objectives, notably in terms of profitability and income diversification.

Enviable profitability

Operating income rose from $342 million to $380 million, or from $1.86 to $2.07 per share. On this basis, the return on common shareholders' equity was 14.1%, compared to 14.0% in 1997. Dividends, at 66¢ per share for the year, were up by 14.8%.

However, the Bank decided to take a $64 million one-time charge to cover the write-off of goodwill from the acquisition of General Trust of Canada. When this adjustment was applied to the Bank's results, net income for the year amounted to $316 million or $1.69 per share.

Assets increased by 6.7% during the year, to $70,663 million. Excluding resale agreements, asset growth amounted to 15.1%, or $8,636 million more than at the end of fiscal 1997. The substantial increase of 9.2% in loans and bankers' acceptances accounted for 43% of the growth in balance sheet assets.

The Bank also continued to diversify its revenue streams. Other income was up by 8.1% to $1,142 million, and represented 46.6% of total income, compared to less than 40% five years ago. The relative growth in other income stemmed mainly from the addition of a vast range of products to the Bank's traditional banking activities, in response to client demand.

The geographic distribution of its income is another aspect of the Bank's diversification. While its principal markets continue to be in Quebec, a significant portion of its income is earned outside the province. For instance, 25% of income with respect to banking services for individuals and small and medium-sized enterprises is generated outside Quebec.

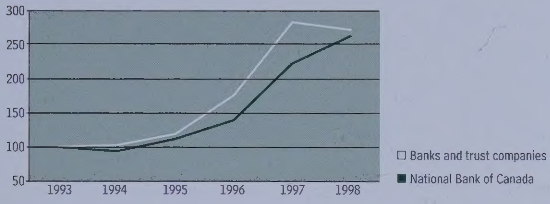
The general allowance, which already stood at $200 million, was increased by $300 million in 1998 in accordance with the guidance provided by the Superintendent of Financial Institutions Canada to all deposit-taking institutions to raise their general allowance as a precautionary measure (see Note 25 to the consolidated financial statements on page 71). Because of its very strong capital structure, the Bank was able to comply with the Superintendent's request immediately. The additional general allowance does not affect the year's results since it was charged to retained earnings, as specified by the Superintendent in the case of significant adjustments.

In spite of turbulent financial markets, the Bank was rewarded with stable results for the prudent approach adopted in recent years. Against the backdrop of the Asian economic crisis, some cracks began to show in the Russian and Latin American economies, and a number of mutual funds experienced serious difficulties. But as the National Bank had carefully avoided the riskiest financial markets and withdrawn from certain financings before any problems developed, it escaped the turmoil virtually unscathed.

A notable highlight of the year was the remarkable performance of Bank shares on the stock market. Total return to shareholders, or dividends plus share price appreciation, was 18.2%; in contrast, the composite of Canadian banks and trust companies, hard hit by the downturn on international financial markets, posted a total return of -3.9%. Over the past five years, National Bank shareholders have enjoyed a total return equal to 97% of the average return on common shares posted by Canadian banks and trust companies.

The rise in the Bank's share price is evidence that investors recognize the National Bank as a solid financial institution, capable of sustained profitability and offering strong potential.

Total return to shareholders (November 1, 1993 = 100)



The uniqueness of the National Bank

The results for 1998 underscore the National Bank's advantages. Large international banks benefit at times from their more diversified revenue streams and investment opportunities, but as recent experience has shown, those banks are also more vulnerable to upheavals in the global economy. Banks with a solid regional base are more easily able to protect themselves because they operate in a more predictable environment and with clients who are familiar to them.

The National Bank is just such a bank: it serves a clientele it knows well, in markets where it has acquired many years of experience and considerable expertise. It is diversified inasmuch as it accompanies its clients into other geographic markets. Outside its core market, the Bank is a niche player in markets where it has specialized knowledge. In other words, it reaps the benefits both of a regional market and of limited, prudent geographic diversification.

It should therefore come as no surprise that the markets have recognized the National Bank's potential for profitability.

In its core market, the National Bank is known as a diversified financial network offering the full array of financial products demanded by its clients. The new corporate structure instituted in 1998 more accurately reflects the scope and nature of the Bank's activities. Under the direction of the Chairman of the Board and Chief Executive Officer, two presidents head up the two main components of the Bank: the Personal and Commercial sector, and the Financial Markets, Treasury and Investment sector.

Integrated into the community

An institution like the National Bank makes an important contribution to the society it serves.

In this context, it is worth recalling that it is competition which allows the banking industry to respond to the needs of clients. It is competition, not size, that makes a bank efficient. That is why the National Bank considers it important to maintain competitiveness within the Canadian banking and financial system. If further proof was needed that a medium-sized bank could be as efficient and profitable as a large one, the National Bank delivered it in 1998.

We would like to take advantage of this opportunity to reaffirm the National Bank's basic mission, namely, to be a commercial bank with a solid base in Quebec and throughout Canada. It provides its primary clientele of consumers and businesses with comprehensive financial services while offering specialized services in secondary markets.

Through this combination of specialization and diversification, the National Bank is able to ensure the highest calibre of financial services for its clients, and a stable, attractive return for its shareholders.

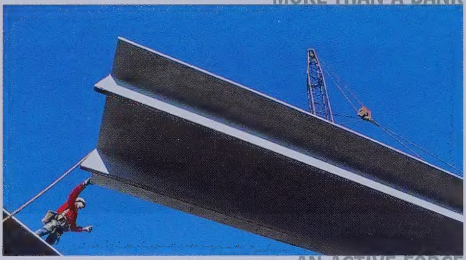
Finally, we would like to express our appreciation to three members of the Board of Directors for their many years of loyal service. In accordance with the Bank's policies, Gaston Malette, Gordon F. Osbaldeston and Paul-Gaston Tremblay will not be standing for re-election in 1999.

To sum up, the National Bank's performance in 1998 brought it considerably closer to achieving its objectives. It made substantial progress in narrowing the profitability gap with the other major Canadian banks; its shareholders enjoyed a superior total return on their investment; and it continued to diversify its revenue streams while remaining faithful to its basic mission as a commercial bank with a strong regional base, which constitutes a stabilizing factor in times of international economic turmoil.

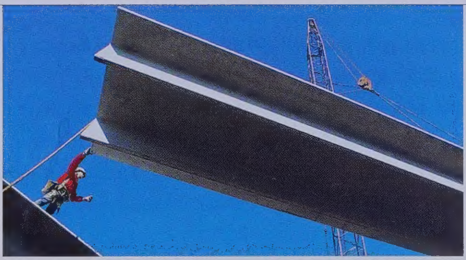
André Bérard
Chairman of the Board and Chief Executive Officer

Léon Courville
President, Personal and Commercial Bank, and Chief Operating Officer

Jean Turmel
President, Financial Markets, Treasury and Investment Bank



AN ACTIVE FORCE IN THE ECONOMY



National Bank of Canada makes an important contribution to society in three distinct ways: as an active force in the economy, in the workplace and in the community.

A bank makes profits and creates value by providing consumers with the financial products and services they need. For many years, consumer demand focused on services involving intermediation between savers and borrowers. However, in recent years, financial markets have undergone a transformation, financial products have become more complex and more varied, technological advances have modified distribution methods and networks, and consumer demand itself has evolved. The banker's role has also changed dramatically, and now incorporates that of financial advisor as well.

Providing financial advice is one area where a banker is absolutely indispensable. That is why the Bank has transformed itself in the past few years into a financial network that can give clients advice and deliver the full spectrum of financial products that will meet their needs.

Loans to small and medium-sized enterprises is another area where bankers are better positioned than any other financial intermediary.

Large corporations have numerous avenues for accessing financial markets, if for no other reason than because information about them circulates freely and is readily available from a variety of sources, including financial analysts, the media and share prices. At the other end of the continuum, individuals also have access to a number of credit providers in a market characterized by relatively homogeneous products, diversified portfolios and a computerized approval process.

When it comes to small and medium-sized enterprises (SMEs), however, the situation is very different. Without the banks, their sources of credit would dry up. The banker is the only one who can accurately gauge the opportunities and constraints of smaller companies, as well as their risks and requirements, because only the banker has an ongoing business relationship and personal contact with the people running them. Such companies are too small to access capital markets, but too complex to be attractive to non-bank financial institutions. For SMEs, therefore, the banks play an irreplaceable role as financial intermediary.

Economic information is a bank's stock in trade. Banks produce the same kind of information on SMEs as financial markets produce solely on large corporations listed on a stock exchange. Working jointly with the owners and officers of client SMEs, the banks identify the relevant information on each company's risks and credit requirements.

It is essential for banks to be present and involved in society. Indeed, bankers have to be active in the community if they want to keep abreast of what is happening in the economy and in local businesses.

A bank with a solid regional base, like the National Bank, enjoys an important competitive advantage: it knows the milieu and is in a good position to do business with local entrepreneurs. It is easier and more natural for a local and regional bank to be active in the life of the community. By extension, it is more effective as a lender and financial advisor to SMEs operating in that community.

The constant interplay between the social and economic roles of a regional bank is apparent in a variety of ways, notably in promoting entrepreneurship. In 1998, the Bank invested approximately $13 million in venture capital funds, including some $8 million in Quebec-based funds. Of the $8 million invested in Quebec, $5 million went to regional cooperative funds, and $3 million to private funds specializing in high-tech sectors.

Its regional presence and the relationships it has formed with local business also make it natural for the Bank to celebrate entrepreneurial success, as it does each year with the annual gala and other events that are part of "The Small and Medium-Sized Enterprises of the National Bank" recognition program.

As a bank at the service of its clients, the National Bank contributes to the prosperity of individuals and businesses alike. Its contribution is enhanced by its uniqueness as an institution with deep roots in its core market, where it is the bank of choice for independent business. Its strong regional base gives it a twofold advantage: it serves as a springboard to markets abroad, where the Bank accompanies its clients, and affords it some shelter when international financial markets are in turmoil.

AN ACTIVE FORCE IN THE WORKPLACE

Another way in which the National Bank contributes to society is as an employer. In 1998, the Bank and its subsidiaries employed 17,084 people, or 4.7% more than in 1997. Together, they distribute over $800 million in salaries and staff benefits.

Were it not for the employees' contribution to the organization, however, there would be no organization to make a contribution to society. The upheavals experienced in the financial sector in recent years have required some adjustments to be made, that in turn have had an impact on the Bank's personnel and their work. Employees have had to be creative in always finding ways to help the Bank respond to the evolving needs of consumers and an increasingly competitive market.

The state of change that is now a permanent feature of the economic and financial environment means that organizations have to be very flexible, and consequently, so do their employees. They must constantly re-examine the way they work and be willing to redefine their tasks in order to meet clients' needs more efficiently. And they must understand the necessity of keeping operating costs under control.

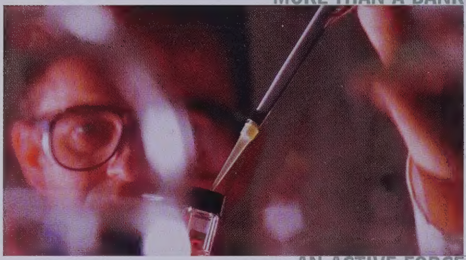
The staff at the National Bank has taken up these challenges with enthusiasm. The transformation of the branch network, the reorientation of personnel towards sales and financial advisory services, knowledge of new financial products, synergy between the components of the National Bank financial network, new credit assessment techniques, computerization of office work, electronic banking: the continuing wave of change has not just been accepted but has been actively embraced by the employees of the Bank and its subsidiaries.

For the personnel of a financial institution, creativity is one of the rules of the game. They must adapt to new methods and new techniques, as well as develop new products and new distribution networks. In the space of only a few years, the electronic bank that clients can access almost anywhere, at any hour of the day or night, has become an important adjunct to the traditional bricks-and-mortar bank.

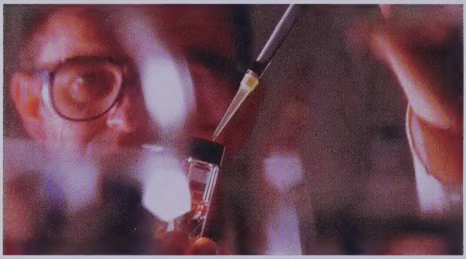
To empower its employees to meet the challenge of adapting to change, of being flexible and creative and of developing entrepreneurship, the Bank has to invest in its intellectual capital. And it does so by offering employees state-of-the-art professional development programs.

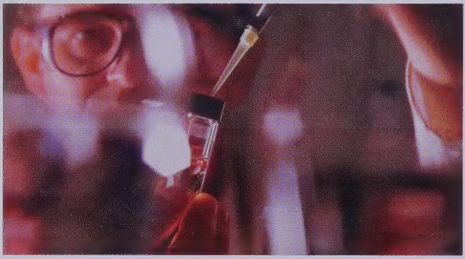
The Bank's role as an educator is clearly evident in the National Bank University Program, which is offered in conjunction with the *Université du Québec* and the Institute of Canadian Bankers. The aim of the program is to expose employees to new ideas and help them to acquire the skills that the bankers of the future will need. More than 3,000 Bank employees have enrolled in the program since it was launched two and a half years ago, and the first employees graduated in 1998.

The *Chambre de commerce du Québec* recognized the excellence of the training offered by the National Bank by giving it a 1998 Mercuriades Award for manpower development.



AN ACTIVE FORCE IN THE COMMUNITY





Yet another way in which the Bank demonstrates its commitment to society is through its support of worthy causes. In 1998, it donated close to $3 million to various community and cultural organizations, as well as to organizations active in education and health care.

The Bank heads the list of donors to United Way and *Centraide*, but a large number of other organizations that are not as well known and which are often regionally based also benefit from the Bank's financial support.

In 1998, fully one-third of the Bank's donations budget, or $921,000, went to community organizations that provide services to the poor and the unemployed, among others. Some $812,000 or 29% of donations went to hospitals, associations that help the sick, medical research funds and other related organizations. Teaching institutions and education foundations accounted for $579,000 or 21% of contributions. Various cultural activities (music, theatre, dance, etc.) received $237,000, or 9% of the Bank's donations budget. The remaining $214,000 was donated to a number of other charitable causes.

The Bank has made a notable contribution to improving the quality of hospital care in Quebec, donating close to half a million dollars to hospitals and hospital foundations. Moreover, this contribution does not only take the form of direct financial support as evidenced by the personal involvement of the Bank's executives. For instance, André Bérard, Chairman of the Board and Chief Executive Officer, acted as president of the fund-raising campaign of the *Association québécoise de la fibrose kystique* for the eighth consecutive year, and was also president of the Montreal Heart Institute's fund-raising drive.

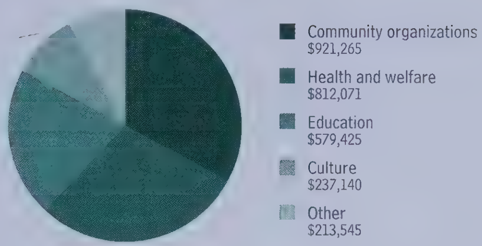
In addition, Léon Courville, President, Personal and Commercial Bank, and Chief Operating Officer, headed the fund-raising campaign for *Générations*, the Quebec association responsible for the telephone help lines of *Tel-jeunes* and *Parents anonymes*, while Jean Turmel, President, Financial Markets, Treasury and Investment Bank, acted as honorary president of the fund-raising campaign for the *Notre-Dame-de-la-Merci* hospital foundation.

Many Bank employees make their own personal contribution to the causes supported by the Bank, by accepting donations for charitable campaigns held in the branches and through volunteer work with various organizations.

The Bank's commitment to society takes many forms, growing out of its roots in the communities that are home to its clients and employees. For its individual and SME clients, the National Bank is a neighbourhood bank, ready to help them in their day-to-day affairs as well as with their major projects. The importance the Bank attaches to its advisory role further strengthens its relations with its clients. And for its employees, the Bank is a place of professional growth and enrichment.

The active role which the Bank and its employees play in local communities has developed naturally from the fabric of personal relationships woven between the Bank and its clients in the course of doing business together.

CHARITABLE DONATIONS BY THE NATIONAL BANK, 1998



MAJOR SECTORS OF THE BANK

The National Bank financial network, comprising the Bank and its various subsidiaries, provides a comprehensive range of financial products and services to both retail and commercial clients in its core market. The Bank also accompanies its clients to other parts of the world, occupying specialized niches outside its core market.

The Bank is made up of two distinct entities: the Personal and Commercial Bank and the Financial Markets, Treasury and Investment Bank, each of which is headed by its own president. Below is an overview of the products and operations of these two entities, the first of which is itself divided into two distinct segments, namely, the Personal Banking and Wealth Management sector and the Commercial Banking sector. Small and medium-sized enterprises are accommodated by the Commercial Banking sector while larger companies are serviced by the Corporate Banking team, which forms part of the Financial Markets, Treasury and Investment Bank.

Table 2.1 provides a breakdown of the year's results by Bank sector. In 1998, Personal Banking and Wealth Management accounted for 51% of the Bank's net income, Commercial Banking for 26% and Financial Markets, Treasury and Investment Banking for 23%. Changes in the consolidated results for the Bank as a whole are analyzed in Management's Discussion and Analysis.

THE BANK'S DISTRIBUTION NETWORKS

Physical distribution networks
- 646 conventional branches of the Bank and General Trust of Canada
- 14 new-concept branches (in supermarkets and post offices)
- National Bank Financial Services
- Offices and representatives of Lévesque Beaubien Geoffrion
- Mortgage development officers
- Toronto Mortgage Centre
- Indirect loans via car dealerships
- "Silver Star" representatives for retirement income plans
- InvesTel: securities brokerage
- InvesNat
- Telemarketing
- 747 banking machines across Canada
- 368,000 banking machines affiliated with the Cirrus and MasterCard networks throughout North America and Europe

Electronic distribution networks
- Interac debit cards
- TelNat telephone banking services
- Personal CompuTeller
- Interactive Web site at www.nbc.ca
- Electronic payment systems

Emerging networks
- Virtual bank
- Smart cards
- Interactive kiosks

TABLE 2.1

Results by Sector of Activity

for the year ended October 31, 1998
(taxable equivalent basis, millions of dollars)

	Personal Banking and Wealth Management	Commercial Banking	Financial Markets, Treasury and Investment Banking	Other (1)	Total (1)
Net interest income	768	273	124	145	1,310
Other income	698	107	206	131	1,142
Gross income	1,466	380	330	276	2,452
Provision for credit losses	58	88	2	45	193
Non-interest expenses	1,078	138	179	194	1,589
Income before income taxes	330	154	149	37	670
Income taxes	130	57	59	13	259
Non-controlling interest	4	–	4	23	31
Net income	196	97	86	1	380
Average assets	22,760	12,253	31,022	(162)	65,873
Loans and bankers' acceptances	22,500	12,173	7,081	(550)	41,204
Deposits	22,225	2,261	19,039	703	44,228

Personal Banking and Wealth Management: This sector consists of the branch network, intermediary services, full-service retail brokerage, discount brokerage, mutual funds, trust services, credit cards and insurance.

Commercial Banking: This sector consists of commercial banking services in Canada and the United States.

Financial Markets, Treasury and Investment Banking: This sector consists of corporate lending, treasury operations which include asset and liability management, corporate brokerage and portfolio management.

Other: This heading includes the real estate sector, the international division and the unallocated portion of centralized service units.

(1) Excluding write-off of $64 million of goodwill.

PERSONAL BANKING AND WEALTH MANAGEMENT

An advisory bank

Through its multi-faceted distribution network, Personal Banking and Wealth Management offers individuals and small business clients a full spectrum of financial products and services. The Bank strives to provide all its clients with the products and services that match their specific needs and priorities, along with advice they can rely on to make sound financial decisions.

One of the Bank's main strategic objectives as regards personal banking is to expand its advisory services and to coordinate such services among all the members of the National Bank financial group. It was precisely for this reason that, in 1998, branch business hours were changed so that personnel could spend more time meeting with clients, that 50 new financial planners were added to the hundred or so already in the branches and that 300 personal bankers also joined their ranks. The growing popularity of electronic networks for routine banking transactions has also enabled personnel to devote more time to fulfilling their crucial role as financial advisors.

Greater accessibility is the other key component of the Bank's strategy with respect to personal financial services. Accordingly, the "physical" distribution networks are now complemented by a variety of new electronic networks that make banking services more available than ever before.

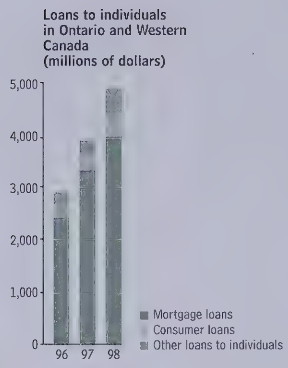
FINANCIAL PRODUCTS OFFERED TO INDIVIDUALS BY THE NATIONAL BANK AND ITS SUBSIDIARIES

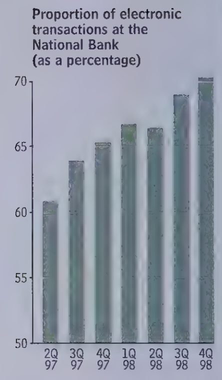
Financial advice
Financial planners, personal bankers, account managers, wealth management, access to all products offered by the National Bank financial network

Transactions and payment methods
Transaction accounts in Canadian dollars and other currencies, credit and debit cards, travellers' cheques, bank drafts, funds transfers

Credit
Personal loans, consumer loans and credit card advances, mortgage loans

Investments and other products
Savings accounts, term investments, mutual funds, registered retirement savings plans and retirement income options, securities (full-service or discount brokerage), insurance, custodial services





The number of service outlets, which rose in 1998, includes nine branches in supermarkets (five of which were opened in 1998) and five experimental branches in post offices. The Bank's experience with these non-traditional branches has been so positive that it has stepped up its development program in this regard.

Still with a view to improving accessibility and further diversifying its distribution networks, the Bank created a transaction Web site (www.nbc.ca). Bank clients can now carry out their day-to-day banking transactions directly on the Internet.

Distribution networks are expanding and changing so rapidly that the boundaries between the physical networks and the new electronic ones are becoming increasingly blurred. Other new networks are also emerging, such as interactive kiosks with video terminals that allow clients to deal directly with a financial advisor, not to mention Direct.N@t, the cornerstone of our virtual bank, which we are currently developing on the Internet.

A growing bank

Table 2.2 summarizes the results of the Personal Banking and Wealth Management sector. Results for 1998 are characterized by higher gross income and a lower provision for credit losses.

The increase in gross income resulted from the combined effect of a drop in net interest income (-5.1%) and a strong rise in other income (+10.4%). Net interest income for Personal Banking declined because of lower deposit volumes in the traditional network and, more particularly, the securitization of a portfolio of credit card receivables valued at $500 million. Other income, by contrast, rose sharply fuelled by commissions on the securitization operation, insurance activities, InvesNat mutual funds and income generated by InvesTel, the Bank's discount brokerage arm.

Further to its acquisition by another company, Metropolitan Life chose to terminate its agreement with the Bank – a partnership that had enabled National Bank Financial Services to build up a solid network of agents. This Bank subsidiary, which offers life and health insurance, decided to step in and independently develop the Bank's share of the insurance market, especially life insurance and complementary hospital insurance. Its strategy is to offer insurance through the networks already being used to sell trust and wealth management products.

General Trust of Canada mutual funds were merged in 1998 with the InvesNat family of mutual funds offered by National Bank Securities, thereby bringing the total number of mutual funds offered by this subsidiary to 25.

During the year, the Bank demonstrated its initiative with respect to investment products by being the first financial institution to launch protected mutual funds. These funds, which are insured by National Bank Life Insurance Company, come with a guarantee that protects the value of the capital invested in the event of the holder's death or in the event of market fluctuations. Another notable innovation was InvesTel's launch of a new Web trading site called InvesNet.

The number of credit cards issued by the Bank rose 5%. A new purchasing card for employees of large companies introduced at the beginning of the fiscal year proved to be a resounding success. Debit card purchases, for their part, were up 24% in value and generated 28% more income for the Bank.

By the end of 1998, 17,000 subscribers were enrolled in Personal CompuTeller, the Bank's computer banking service. To further broaden the availability of basic banking services, the Bank also created a firm that supplies mini-banking machines which merchants can operate themselves in places where it is not economically feasible for the Bank to do so.

Our clients now use the Bank's electronic networks to carry out 70% of their transactions. The above chart shows how the relative number of physical and electronic transactions has changed in the past seven quarters.

TABLE 2.2
Results by Sector of Activity
Personal Banking and Wealth Management
for the year ended October 31
(taxable equivalent basis, millions of dollars)

	1998	1997	1996
Net interest income	768	809	763
Other income	698	632	535
Gross income	1,466	1,441	1,298
Provision for credit losses	58	100	115
Non-interest expenses	1,078	1,002	900
Income before income taxes	330	339	283
Income taxes	130	134	109
Non-controlling interest	4	4	4
Net income	196	201	170
Average assets	22,760	22,005	21,016
Loans and bankers' acceptances	22,500	21,752	20,756
Deposits	22,225	23,450	23,984

Fiscal 1998 saw a large increase in the Bank's domestic loan portfolio outside Quebec. In Ontario and Western Canada, residential mortgage volumes rose by close to 20% and consumer loans by more than 25%. Overall, loans to individuals in these regions grew by 19%.

LÉVESQUE BEAUBIEN GEOFFRION

Lévesque Beaubien Geoffrion, a subsidiary in which the Bank has a 75% interest, is the leading securities broker in Quebec and ranks seventh Canada-wide. It has offices in Montreal, Toronto, Vancouver, Calgary, Winnipeg, Halifax, New York, London and Geneva.

Lévesque Beaubien Geoffrion offers a wide range of brokerage services and other financial products to individual, institutional, government and corporate clients.

The company, with some 2,000 employees, recorded total income of $387 million in 1998 and net earnings of $30 million. It has over $24 billion in assets under administration/management.

Moreover, according to the Canadian financial institutions surveyed by Brendan Wood, the research services of Lévesque Beaubien Geoffrion are ranked among the very best.

In 1998, Lévesque Beaubien Geoffrion pursued its goal of increasing its share of the retail market. Accordingly, it set up new agencies, appointed new regional representatives and made certain acquisitions in Montreal and Western Canada.

In terms of corporate financing, Lévesque Beaubien Geoffrion seeks to play a dominant role in all areas of corporate financing in Quebec and to expand its presence outside Quebec.

After posting strong growth in the first half of the year, Lévesque Beaubien Geoffrion's earnings fell in the second half as a result of adverse financial market conditions. All in all, the company's net earnings declined by 36% in fiscal 1998.

SIBN (formerly National Bank Information Corporation)

SIBN, a wholly-owned subsidiary of the National Bank, offers business clients electronic solutions to the challenges posed by information management and electronic commerce. It also ensures that the Bank remains at the forefront of leading-edge information technology.

The services offered to SME clients include:
- electronic commerce advisory services
- payroll processing
- cash management (ClickFinance and ClickPayment software)
- SAP integrated management software
- electronic data interchange (EDI)
- payment systems
- management of electronic networks

COMMERCIAL BANKING

A bank with solutions

Commercial Banking encompasses all of the financial services that the Bank offers SMEs in its core market of Quebec as well as the specialized services it makes available to business clients elsewhere in Canada and in the United States.

This sector serves the needs of close to 165,000 business clients through 40 commercial banking centres, five international centres in Canada and a worldwide network of subsidiaries, partners, branches and representative offices.

The National Bank aims to be the bank which SMEs can turn to for solutions. Working in tandem with its various subsidiaries, it prides itself on providing its business clients with diverse, innovative and integrated solutions to their financing, treasury and management needs.

The bank of SMEs

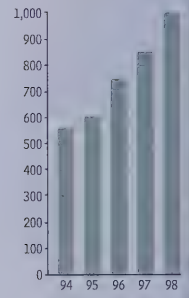
In 1998, gross income in the Commercial Banking sector rose by 10.1%, driven by strong growth in net interest income (+9.6%) and other income (+11.5%).

Higher loan volumes to business in Canada and the United States essentially accounted for the growth in net interest income from operations with the Bank's commercial clientele. Moreover, the Bank's share of the SME market in Quebec rose again in 1998.

TABLE 2.3
Results by Sector of Activity
Commercial Banking
for the year ended October 31
(taxable equivalent basis, millions of dollars)

	1998	1997	1996
Net interest income	273	249	237
Other income	107	96	101
Gross income	380	345	338
Provision for credit losses	88	62	50
Non-interest expenses	138	114	112
Income before income taxes	154	169	176
Income taxes	57	67	70
Non-controlling interest	–	–	–
Net income	97	102	106
Average assets	12,253	10,631	9,267
Loans and bankers' acceptances	12,173	10,530	9,164
Deposits	2,261	2,056	1,906

Agricultural loans held by the National Bank in Quebec (millions of dollars)



The leading bank in Quebec, the National Bank also ranks first in many sectors of the economy. In the agricultural sector, for instance, the Bank's portfolio has increased steadily in recent years, with agricultural loan volumes in Quebec reaching the $1 billion mark at year end. In fact, one in five Quebec farmers has a loan with the National Bank.

The 41 professional agronomists who make up the Bank's team of account managers and business development managers in its rural branches are well-placed to advise their clients and to recommend the products and financial strategies best suited to their needs. Loan losses in this sector are negligible, mainly because most of the loans are guaranteed in part by the government. The Bank also plays a dominant role in the agribusiness industry.

In addition to holding a major share in its core market, the Bank has carved out lucrative niches for itself in certain specialized products for SMEs. Drawing on its experience in asset-based lending, the Bank organized a similar operation for structured financing in the form of term loans for industrial equipment. The Bank also acquired a majority interest in Alter Moneta Corporation, a new company specializing in lease financing of industrial equipment.

FINANCIAL PRODUCTS OFFERED BY THE BANK TO ITS SME CLIENTS

Credit, deposits, transactions
Operating loans, term loans, bankers' acceptances, financing of accounts receivable, premises, equipment and inventory, MasterCard credit card for businesses, investments and cash management as well as transaction accounts and current accounts in Canadian dollars and other currencies

Electronic services
Electronic data interchange (EDI), SECURNAT, SAP management software, InfoFinance for PC banking, payroll processing

International services
Cross-border and international financial services, letters of credit and guarantee, export credit, NBC Export Development Corporation, NatExport

Advisory and specialized services
Global cash management manager, international financial advisors, trust services, securities administration and management, employee benefits management, retirement plans, a CD-ROM containing business solutions and a program for drafting business plans, personalized financial advice, specialized financing groups for the high-tech, film and franchise sectors, etc. and underwriting services through Lévesque Beaubien Geoffrion

Loans to SMEs in the United States constitute a large portion of the Bank's portfolio outside Quebec. These are specialized markets (such as asset-based lending) which are rapidly evolving. The new office that was opened in Seattle will enable us to further consolidate our presence in these markets.

The increase in other income earned by Commercial Banking was primarily attributable to commissions on loans and bankers' acceptances, with the United States accounting for more than half of the rise.

Among the services which recorded a sizeable jump in other income was the Bank's payroll processing service which saw its earnings climb 18% in 1998. In fact, the National Bank is the only major Canadian bank to operate its own payroll service for the benefit of its business clients.

Growth in commercial volumes and income was accompanied by a 21.1% rise in operating expenses caused mainly by business expansion in the U.S. market and the cost of new technologies, in particular those associated with the final phase of implementing the computerized financial analysis system.

The increase in the provision for loan losses was due solely to the U.S. market, and can be explained by the remarkable performance of the commercial portfolio between 1995 and 1997.

Each client has its own particular financing, cash management, investment and management problems. The Bank can provide solutions in the form of the many credit facilities, financial products, support and advisory services that it and its subsidiaries have to offer business clients. The Bank's commitment to SMEs is clearly evident in its latest advertising campaign in which the term "inc.", so closely linked to the business world, visually integrates the Bank's logo.

FINANCIAL MARKETS, TREASURY AND INVESTMENT BANKING

Comprehensive array of financing products

This sector groups together all the financing services which the Bank and Lévesque Beaubien Geoffrion provide to corporate and institutional clients as well as the investment and trading operations which Treasury carries out on financial markets.

Treasury is responsible for the Bank's own management operations as well as for hedging operations on behalf of clients. The Bank's management operations include liquidity and securities management, asset and liability management and risk hedging for certain financial instruments. Hedging operations for clients enable them to protect themselves against fluctuations in exchange rates or other changes in financial markets.

Lévesque Beaubien Geoffrion, the Bank's brokerage subsidiary, offers brokerage, portfolio administration or management, and research services to institutional investors (mutual funds, insurance companies, pension funds, etc.). Corporate clients, for their part, can look to Lévesque Beaubien Geoffrion for complete access to financial markets, public offerings, advisory services for mergers and acquisitions and other sophisticated financing alternatives.

To give tangible form to the close cooperation that is essential when it comes to finding integrated, innovative financing solutions for very large companies, the Bank's Corporate Banking sector was merged with the corporate financing arm of Lévesque Beaubien Geoffrion. The Bank's goal is to achieve a dominant position in all areas of corporate financing in Quebec while ensuring accelerated development outside Quebec.

The box on this page describes the major categories of financial products made available to corporations and institutional investors by Corporate Banking, Treasury and Lévesque Beaubien Geoffrion.

Another Bank subsidiary, Natcan Investment Management, provides financial management services to a wide variety of companies and institutions, including pension funds and institutional investors.

EXAMPLES OF SPECIALIZED FINANCIAL PRODUCTS OFFERED TO CORPORATIONS BY THE BANK AND LÉVESQUE BEAUBIEN GEOFFRION

Securities
Bonds, public sector securities, strip coupons, securities purchased under resale agreements, mortgage-backed securities, shares, Toronto Stock Exchange index-linked products, convertible debentures

Derivatives
Interest rate and currency options and swaps, futures, equity derivatives, pulp and paper derivatives, structured notes

Other money market instruments
Treasury bills, commercial paper, term deposits, promissory notes, bankers' acceptances, bankers' acceptance futures

Investment banking
Mergers and acquisitions, structured financing, underwritings, securitization, advisory services

Research
Forecasts and analyses concerning economic conditions and financial markets, fundamental and quantitative research

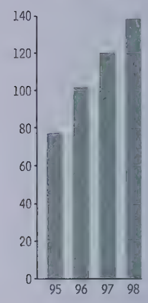
Prudent growth

The Bank was not spared some of the indirect effects of the international financial crisis even though it had no financial assets in Russia and its commitments in Asia were limited and not of a speculative nature. The downturn in financial markets starting in July served to curtail the volume of financing operations with clients. However, the drop in the Canadian dollar and the volatility of other currencies made foreign exchange operations more profitable because of clients' greater hedging needs.

TABLE 2.4
Results by Sector of Activity
Financial Markets, Treasury and Investment Banking
for the year ended October 31
(taxable equivalent basis, millions of dollars)

	1998	1997	1996
Net interest income	124	105	82
Other income	206	261	234
Gross income	330	366	316
Provision for credit losses	2	17	4
Non-interest expenses	179	168	167
Income before income taxes	149	181	145
Income taxes	59	70	56
Non-controlling interest	4	9	6
Net income	86	102	83
Average assets	31,022	22,719	17,493
Loans and bankers' acceptances	7,081	4,876	3,977
Deposits	19,039	14,301	11,964

Bank and Lévesque Beaubien Geoffrion income from corporate financing (millions of dollars)



The deterioration in gross income for the sector derived from the decline in other income, which fell from $261 to $206 million. This situation was almost wholly attributable to the lower income earned by Treasury and Lévesque Beaubien Geoffrion as a result of the upheaval on financial markets during the fourth quarter.

Net interest income rose by 18.1%, driven by an increase in credit granted to corporations. This performance was achieved in an environment of fierce competition, especially from non-traditional international lenders.

Since 1995, annual income from corporate financing earned by Corporate Banking and Lévesque Beaubien Geoffrion has risen by $61.6 million or 80%. Approximately one quarter of this income was generated by the brokerage subsidiary.

Cooperation between Lévesque Beaubien Geoffrion and Corporate Banking was further enhanced during the year. One of the results was the development of a new derivative product for stock options. In addition, the money market operations of the Bank and Lévesque Beaubien Geoffrion were consolidated and our offices in London, England were merged.

Also worth mentioning for 1998 is that Treasury created a new department for stock market index derivatives while Natcan Investment Management acquired Kogeva Investments International Inc., enabling it to consolidate its international asset management activities in Montreal and concentrate on developing a number of innovative financial products.

OTHER ACTIVITIES

The "Other" category comprises real estate, international operations other than U.S. and the unallocated portion of centralized service units. The increase in the Bank's net income is concentrated in this category because of various factors related to the procedures for allocating income and costs as well as the reduction in the provision for credit losses in 1998.

TABLE 2.5
Results by Sector of Activity
Other
for the year ended October 31
(taxable equivalent basis, millions of dollars)

	1998	1997	1996
Net interest income	145	161	60
Other income	131	67	100
Gross income	276	228	160
Provision for credit losses	45	111	66
Non-interest expenses	194	205	234
Income before income taxes	37	(88)	(140)
Income taxes	13	(28)	(99)
Non-controlling interest	23	3	–
Net income	1	(63)	(41)
Average assets	(162)	330	1,463
Loans and bankers' acceptances	(550)	339	138
Deposits	703	545	750

The twofold mission of the International division is to provide Bank clients in North America with the financial and strategic tools they need on foreign markets and to find profitable business opportunities for the Bank outside North America.

In 1998, the International division created a new position, that of business development manager for international services, in each of the Bank's regions in Quebec. The manager's role is to advise business clients on how to manage the risks inherent in their international commercial operations, as well as give information and advice on the types of export financing that apportion the risk between the Bank and government agencies. He or she also refers clients to the other departments in the National Bank's financial network which are best qualified to meet their varied needs.

The Bank received authorization in 1998 to expand its international network by opening a branch in Beirut. In addition to its office in New York, the Bank's network is comprised of offices in London, Paris, Mexico City, Nassau, Hong Kong, Shanghai, Beijing, Taipei, Singapore and Seoul. Our stake in Corp Group of Santiago, Chile gives Bank clients access to a banking network in Argentina, Chile and Venezuela. Thanks to cooperation agreements with financial institutions in France, Belgium, Germany, Austria, Italy, Portugal, Spain and the United Kingdom, together with a network of 2,800 banking correspondents covering more than 120 countries, the Bank can boast an international character that enables it to serve its clients wherever they do business.

As a result of its prudent international expansion strategy, the events that shook markets in Asia, Russia and Latin America had relatively little impact on the Bank. In 1998, the private loan sector of the International division recorded 19% growth in net income owing to the lower provision for credit losses.

TABLE 2.6
Personal Banking and Wealth Management Gross Income by Type of Activity
(taxable equivalent basis, millions of dollars)

	1998	1997	1996
Personal banking	885	896	896
LBG – retail	261	260	170
Trust services	34	29	28
Discount brokerage and mutual funds	72	60	39
Credit cards	175	178	153
Insurance	39	18	12
	1,466	1,441	1,298

(as a percentage)

	1998	1997	1996
Personal banking	60.4	62.2	69.0
LBG – retail	17.8	18.0	13.1
Trust services	2.3	2.0	2.2
Discount brokerage and mutual funds	4.9	4.2	3.0
Credit cards	11.9	12.4	11.8
Insurance	2.7	1.2	0.9
	100.0	100.0	100.0

A DIVERSIFIED BANK

In accordance with its objectives, the Bank has greatly diversified its revenue streams in recent years. Table 2.6 shows the changes in the Bank's gross income (net interest income and other income) earned by Personal Banking and Wealth Management, broken down between traditional banking operations and other types of financial activities. Non-traditional financial activities now account for close to 40% of gross income, compared to 31% three years ago.

TABLE 2.7
Personal Banking and Wealth Management and Commercial Banking Geographic Distribution of Gross Income
(taxable equivalent basis, millions of dollars)

	1998		1997	
	$	%	$	%
Quebec	1,399	76	1,368	77
Ontario and Western Canada	266	14	253	14
Atlantic Canada	52	3	50	3
Total in Canada	1,717	93	1,671	94
United States	129	7	115	6
Total	1,846	100	1,786	100

Similarly, the Bank has diversified its geographic sources of income in both the Personal Banking and Wealth Management sector and in the Commercial Banking sector. Table 2.7 shows that although the Bank's principal markets are still in Quebec, a quarter of its income comes from outside Quebec.

The National Bank is a personal and commercial bank on the one hand, and a participant in international financial markets and a corporate financing bank on the other. In its core market, it is an integrated financial network offering a complete range of financial products and services. Elsewhere in the world, it accompanies its clients and operates in specialized niches where it can put its expertise to good use. In fiscal 1998, the Bank succeeded in achieving its objectives and meeting its clients' expectations.

The world economy

The Asian crisis in October 1997 and the ensuing fallout had a marked impact on economic conditions in fiscal 1998, as evidenced by the drop in commodity prices. The economic slump in Russia raised tensions on financial markets. The flight to strong currencies such as the U.S. dollar led to the depreciation of South American currencies, making the economic situation worse for countries that in many cases were already in difficulty.

These disruptions depressed stock markets worldwide and led to a general reduction in interest rates.

Continued growth in the U.S. economy

Since the end of the recession in 1991, the U.S. economy has enjoyed one of its longest periods of expansion in the postwar era, and without inflation. But the uncertainty created by problems on the international financial scene has raised fears of a credit squeeze and a global recession that the United States could not escape.

For the time being, however, the jobless rate in the United States is at a 30-year low and interest rates are low as well. Americans' real after-tax income has risen by 20% during the current expansion.

The repercussions of the Asian crisis on the U.S. economy were not all negative. One positive outcome was that it helped to keep the economy from overheating, thereby prolonging the expansion. It also prevented companies from hiding behind inflation and prompted them to increase productivity. Consequently, even when economic conditions return to normal and demand starts rising again, the high degree of competition in the United States should prevent a run-up in prices.

Economic expansion is expected to continue inflation-free in 1999, although at a slower pace than in recent years. Canadian exporters can therefore count on growth in the U.S. market for the next few years.

Problems and opportunities in Canada

Exports were largely responsible for the economic expansion in Canada during the first half of the decade. Since the United States is the main destination for Canadian exports, the direct consequences of the Asian crisis on the Canadian economy were limited. In 1998, however, the value of Canadian exports was strongly impacted by low commodity prices.

Fortunately, domestic demand took over as an engine of growth. While business investment has played an important role in recent economic growth (business investment in machinery and equipment has risen by 30% in Canada since 1996), in the past two years growth was driven primarily by consumer spending, under the impetus of low interest rates and an improved job market.

The lack of growth in Canadian consumers' real income is therefore cause for concern. After-tax real income on a per capita basis has shrunk by over 10% in Canada since its high in 1990. This erosion was triggered by the higher taxes imposed so as to balance public finances. The increase in consumer spending observed in the past two years has therefore been at the expense of savings.

Even though the forecasts for the next few years are for interest rates to remain relatively low, employment to grow and disposable income to rise somewhat, it may not be enough to ensure that consumer spending will continue to stimulate the economy. A significant reduction in the tax burden would be welcome, and is in fact possible now that budget surpluses are starting to appear.

The flexibility of Canada's labour market is reason for optimism about future employment trends. However, there are certain rigid structures that it would be helpful to eliminate; similarly, payroll taxes are an obstacle which ideally would be removed.

Canada's monetary policy was put to a severe test recently, with the Canadian dollar's weakness making the central bank's task all the more difficult. Starting in early 1997 – well before the financial crisis in Asia, the decline in commodity prices and the deterioration in the Canadian current account deficit – anticipated interest rate increases in the United States sent the Canadian dollar tumbling. Since then, the Bank of Canada has had to strike a balance between the objective of stimulating economic growth and the fear of letting the dollar sink too low.

As Quebec's industrial structure is much more diversified than that of the other provinces, the Quebec economy is less cyclical and less vulnerable to global shocks like the Asian crisis.

Since the start of the 1990s, economic growth in Quebec has nonetheless been running below the national average. One of the main reasons for this has been the relative lack of investment in Quebec. However, 1998 marked a change in this regard, and business investment, especially in non-residential construction, seems likely to exceed the Canadian average in 1998 and 1999.

The economic outlook for Quebec would be twice as promising if Quebec consumers were given a tax break.

Impact on the banks

The turmoil on international markets did not leave the financial industry unscathed. Banks which, unlike the National Bank, had substantial positions on Asian, Russian and Latin American financial markets experienced heavy losses. Because of its prudent approach, the National Bank did not suffer any direct effects from the financial shockwaves. This was because the Bank's financial assets in the most heavily affected parts of Asia represented oniy a very small percentage of the portfolio, and the Bank does not hold any assets in Russia.

However, the Bank was not spared some of the indirect effects of the crisis. After earning record income from its brokerage activities in the first half of 1998, the Bank suffered the aftershocks of the stock market decline in the second half. Even so, it was still less severely affected than many other financial institutions.

Sustained job creation across Canada stimulated growth in personal loans. The decline in personal bankruptcies in Quebec (for the first time since 1994) helped to improve the quality of the personal lending portfolio.

The downward trend in commercial bankruptcies in the past two years translates into lower loan losses. As the leading bank for businesses in Quebec, the National Bank stands to gain more than its competitors from the upturn in business investment.

Barring unforeseen events, the economic outlook is good in the National Bank's principal markets. And the Bank is all the more ready to capitalize on opportunities that arise, as it was relatively untouched by the turbulence on international financial markets.

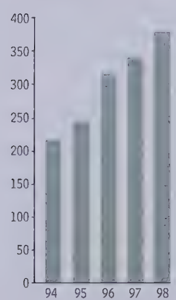
OVERVIEW OF RESULTS

In fiscal 1998, the National Bank once again turned in an excellent overall performance. These good results, however, were generated primarily during the first three quarters of the year as the last quarter was marked by adverse financial market conditions.

The highlights presented at the beginning of this annual report provide certain financial and administrative data concerning the fiscal year. Table 3.1 summarizes the Bank's results on a taxable equivalent basis.

Operating income amounted to $380.1 million in 1998, an increase of 11.3% over 1997. This performance was driven by strong growth in other income, combined with a lower provision for credit losses.

Net income before write-off of goodwill (millions of dollars)



After taking into consideration a write-off of goodwill, net income was $315.8 million. In its operating results for the fourth quarter of 1998, the Bank included a $64.3 million charge corresponding to a write-off of goodwill from the acquisition of General Trust of Canada. This write-off reflects a permanent impairment in the value of this asset, caused notably by the profound changes in financial markets and the new distribution of responsibilities among the components of the National Bank financial group.

Total income, at $2,452.9 million, was up 3.1% resulting from the combined effect of a reduction in net interest income and an increase in other income. Net interest income amounted to $1,310.4 million, down 1.0% from 1997 due to non-recurring items.

Other income climbed $86.9 million or 8.2% to end the year at over $1.1 billion, or almost the same level as net interest income.

A FEW INDICATORS

From 1994 to 1998, the Bank's total assets grew by $25,889 million, for an increase of 57.8%.

From 1994 to 1998, total income rose by 36.1%, net interest income by 20.9%, and other income by 58.8%. Moreover, other income accounted for 46.6% of total income in 1998, up from 39.6% in 1994.

During the past four years, deposit liabilities (aggregate deposits on the Bank's balance sheet) went from $36,850 to $48,026 million, for an increase of 30.3%. Personal deposits declined by 1.4% while commercial deposits and purchased funds rose by 75.5% and 65.2% respectively. During this period, the proportion of core deposits went from 69.9% to 61.9%.

TABLE 3.1

Overview of Results

for the year ended October 31

(taxable equivalent basis, millions of dollars and as a percentage of average assets)

	1998		1997		1996		1995		1994	
	$	%	$	%	$	%	$	%	$	%
Net interest income	1,310.4	1.99	1,323.9	2.38	1,142.2	2.32	1,180.6	2.48	1,094.9	2.54
Other income (1)	1,142.5	1.73	1,055.6	1.90	970.1	1.97	711.6	1.50	719.3	1.67
Provision for credit losses	193.4	0.29	290.0	0.52	235.0	0.48	255.0	0.54	275.0	0.64
Non-interest expenses (2)	1,589.0	2.41	1,488.8	2.67	1,413.1	2.87	1,229.3	2.58	1,168.7	2.71
Income taxes	259.2	0.39	243.1	0.44	135.8	0.28	156.3	0.33	144.6	0.34
Non-controlling interest	31.2	0.05	16.0	0.03	10.1	0.02	6.6	0.02	8.7	0.02
Net income (2)	380.1	0.58	341.6	0.62	318.3	0.64	245.0	0.51	217.2	0.50
Average assets	65,873		55,685		49,239		47,582		43,160	

(1) As of 1996, realized and unrealized gains or losses on securities are recorded under other income.

(2) Excluding write-off of $64 million of goodwill in 1998.

Improved economic conditions in Quebec, the Bank's core market, and the measures taken in recent years to pare down the lending portfolio enabled the Bank in 1998 to reduce its annual provision for credit losses by one third, to $193.4 million.

The increase in income and the reduction in the provision for credit losses more than offset higher operating expenses incurred because of higher business volumes and investments in technology.

As at October 31, 1998, the Bank's total assets amounted to $70,663 million. Excluding securities purchased under resale agreements, assets rose by 15.1% or $8,636 million.

During the year, the Board of Directors of the Bank declared a dividend of 66¢ per common share, 14.8% higher than in 1997. If the write-off of goodwill mentioned earlier is excluded, net income per share continued to grow, reaching $2.07, or 11.3% more than in 1997 when growth of 5.7% was recorded. Return on common shareholders' equity rose slightly to 14.1%, whereas this measure of profitability was down among the other major Canadian banks. The Bank therefore made substantial progress in 1998 in attaining its objective of closing the profitability gap with the other major Canadian banks.

Total return to shareholders for the year (share price appreciation plus dividends) was 18.2%. In contrast, Canadian banks and trust companies, hard hit by the downturn in international financial markets, posted a total return of -3.9% as a whole.

INCOME AND EXPENSES

Net Interest Income

Table 3.2 presents changes in net interest income by major asset and liability category, on a taxable equivalent basis and in the form of average values. Assets generated interest income of $3,324.2 million, for an average interest rate of 5.05%, compared to 5.52% in 1997. Liabilities and shareholders' equity cost the Bank $2,013.8 million in interest, equivalent to a rate of 3.06%, versus 3.14% the previous year. Net interest income ($1,310.4 million) is the difference between interest earned and interest paid on asset and liability volumes, while the interest spread (1.99%) is the difference between average interest rates. The relative contribution of rate and volume variations can be analyzed using the last two columns of Table 3.2, where the net impact is broken down into its volume component and its rate component, calculated at 1998 rates and on 1997 volumes, respectively.

A number of factors were responsible for the 1.0% decline in net interest income. In fiscal 1997, the Bank recorded two non-recurring items, namely, a $20 million gain on past-due interest bonds received from designated countries and a $16 million gain as a result of the securitization of $800 million of residential mortgages. In 1998, however, net interest income was reduced by $30 million through the securitization of a credit card portfolio. Finally, investors continued to shift their funds into instruments which they expected would yield a higher return, such as mutual funds and stock market investments.

On the assets side, interest income rose – in spite of lower rates – by $248.6 million or 8.1% because of higher volumes. More than half of the increase in volumes occurred in business loans, with personal loans also recording significant growth. With respect to interest-bearing liabilities, the increase in interest expense also stemmed primarily from volume growth.

Provision for credit losses (millions of dollars)

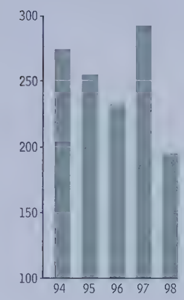


TABLE 3.2

Changes in Net Interest Income

for the year ended October 31
(taxable equivalent basis, millions of dollars)

	1998			1997			1998/1997			$ Variation due to:	
	Average volume	Rate	Interest	Average volume	Rate	Interest	Average volume	Rate	Interest	Average volume	Rate
	$	%	$	$	%	$	$	%	$		
Assets											
Deposits with financial institutions	4,742	5.25	248.8	3,348	4.85	162.4	1,394	0.40	86.4	73.2	13.2
Securities	10,344	2.94	304.4	8,694	3.89	338.4	1,650	(0.95)	(34.0)	48.5	(82.5)
Mortgage loans	13,898	6.61	918.2	13,316	7.16	954.0	582	(0.55)	(35.8)	38.5	(74.3)
Personal loans	6,785	8.25	559.9	6,094	8.59	523.2	691	(0.34)	36.7	57.0	(20.3)
Business and other loans	25,434	5.07	1,288.3	20,241	5.35	1,082.7	5,193	(0.28)	205.6	263.3	(57.7)
Impaired loans, net	272	1.69	4.6	378	3.95	14.9	(106)	(2.26)	(10.3)	(1.8)	(8.5)
Earning assets	61,475	5.41	3,324.2	52,071	5.91	3,075.6	9,404	(0.50)	248.6	478.7	(230.1)
Other assets	4,398	–	–	3,614	–	–	784	–	–	–	–
Total assets	65,873	5.05	3,324.2	55,685	5.52	3,075.6	10,188	(0.47)	248.6	478.7	(230.1)
Liabilities											
Personal deposits	19,842	3.97	788.0	21,112	4.14	874.2	(1,270)	(0.17)	(86.2)	(50.4)	(35.8)
Deposit-taking institutions	8,986	5.31	477.5	7,160	5.32	381.1	1,826	(0.01)	96.4	97.0	(0.6)
Other deposits	15,400	4.47	688.0	12,080	3.76	453.9	3,320	0.71	234.1	148.4	85.7
	44,228	4.42	1,953.5	40,352	4.24	1,709.2	3,876	0.18	244.3	195.0	49.3
Debentures	1,014	7.51	76.2	1,141	7.33	83.6	(127)	0.18	(7.4)	(9.5)	2.1
Liabilities other than deposits	13,113	0.88	115.2	8,169	1.30	105.8	4,944	(0.42)	9.4	43.5	(34.1)
Other (1)	–	–	(131.1)	–	–	(146.9)	–	–	15.8	–	15.8
Interest-bearing liabilities	58,355	3.45	2,013.8	49,662	3.53	1,751.7	8,693	(0.08)	262.1	229.0	33.1
Other liabilities	4,638	–	–	3,382	–	–	1,256	–	–	–	–
Shareholders' equity	2,880	–	–	2,641	–	–	239	–	–	–	–
Impact of non-interest bearing assets and liabilities	–	–	–	–	–	–	–	–	–	47.0	(47.0)
Total liabilities and shareholders' equity	65,873	3.06	2,013.8	55,685	3.14	1,751.7	10,188	(0.08)	262.1	276.0	(13.9)
Net interest income		1.99	1,310.4		2.38	1,323.9		(0.39)	(13.5)	202.7	(216.2)

(1) Other interest income and interest expense including hedging operations.

The last two figures on the last line of Table 3.2 summarize the effect of volume and rate variations on net interest income. As can be seen, the slight change in net interest income was due solely to the fact that the positive impact of volumes ($202.7 million) was more than offset by the negative impact of interest rates (-$216.2 million).

Other Income

Other income, described in Table 3.3, includes all income other than interest and dividend income. In 1998, other income rose from $1,056 million to $1,142 million, for an increase of $86 million or 8.2%.

Fees from lending activities, bankers' acceptances and letters of credit and guarantee, which were up by $34 million or 21.8%, generated most of the growth in other income. This reflects the Bank's increased market share of business loans in its core market as well as the growth of its business in the United States.

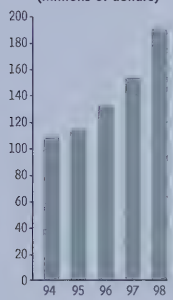
Card service fees paid by retailers were up substantially, rising $28 million or 29.5%. Expansion of the Bank's cardholder base and the rise in cardholder purchase volumes contributed to this strong growth, as did the $19 million in credit card securitization.

From time to time, the Bank elects to securitize some of the components of its portfolio, notably credit card receivables. It sells these receivables to a pool fund or trust of which it is not the beneficiary, thereby reducing its assets and its credit risk. However, the Bank continues to manage the receivables and earns fee income which provides it with a source of funds for a fixed term, while reducing its credit risk and freeing up capital.

Revenues from deposit and payment service charges rose in 1998, reflecting more realistic pricing for these services. Foreign exchange revenues were up 17.9%, mainly because of the higher volume of transactions carried out by clients in response to currency volatility. Trust service revenues were also up as a result of increased business with both companies and individuals.

The "Other" category consists mainly of revenues from mutual funds (up $6 million), insurance products (up $16 million) and electronic services.

Fees from lending activities, bankers' acceptances and letters of credit and guarantee (millions of dollars)



In 1998, capital market fees did not increase on account of the market decline at the end of the fiscal year, which was also responsible for the lower gains on securities.

Given the circumstances, the reduction in these gains was fairly modest. The fact that the Bank did not have any holdings in hedge funds, which were particularly affected by the downturn in financial markets, favoured its performance in this regard.

Other income represented 46.6% of the Bank's total income, compared with 44.4% in 1997. This progression was in line with the Bank's strategy of diversifying its revenue streams and brought it another step closer to its objectives.

Provision for Credit Losses

The substantial reduction in the annual provision for credit losses, from $290 million to $193 million, was chiefly attributable to changes in domestic loss experience. In fact, the provision for credit losses was reduced in all domestic credit sectors. This reduction was particularly marked in the provision for real estate and corporate loans as well as loans to individuals. In all, the provision for domestic risks declined 50.2%, from $231 million to $115 million.

In the United States, however, the Bank had to raise its provision for credit losses from $31 million to $75 million. The higher provision is not indicative of any deterioration in the portfolio: in the commercial sector, it reflects the remarkable performance recorded in the previous few years, and in the real estate sector, it was in line with the ongoing sale of real estate and the paring down of the portfolio.

In the International sector, other than the United States, the provision for credit losses was down significantly as a result of the reduction in assets.

No addition needed to be made to the allowance for designated countries as the portfolio in question was composed mainly of U.S. government-guaranteed bonds. It should be noted that, since the Bank had prudently divested itself of most of its assets in Asia in recent years, the Asian economic crisis had very little impact on its portfolio.

As a percentage of net average loans and bankers' acceptances, the provision for credit losses on private-risk loans was down sharply in both the domestic sector and the International sector, excluding the United States, whereas it rose in the United States. Overall, it amounted to 0.47%, historically a very low level.

Changes to the Bank's allowances and the relevant breakdown are shown in the lower two sections of Table 3.4. The annual provision of $193 million, write-offs and recoveries during the year and the $300 million adjustment to the general allowance, discussed below, resulted in a provision for credit losses of $1,049 million as at October 31, 1998, an increase of 25.0%. The allowances were comprised of a general allowance of $500 million, specific allowances of $492 million, and allowances for designated countries of $57 million.

TABLE 3.3
Other Income
for the year ended October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Capital market fees	313	313	244	193	212
Deposit and payment service charges	144	132	123	133	123
Realized and unrealized gains on securities, net amount	94	153	180	–	–
Card service revenues	123	95	69	64	59
Lending fees	146	115	99	83	81
Bankers' acceptances, letters of credit and guarantee	44	41	35	31	28
Foreign exchange revenues	46	39	50	51	39
Trust services	31	28	20	21	22
Other	201	140	150	136	155
	1,142	1,056	970	712	719
Domestic	1,099	1,024	852	680	688
International – United States	37	29	32	24	25
– Other	6	3	86	8	6
Other income as a percentage of total income	46.6%	44.4%	45.9%	37.6%	39.6%

As of 1996, realized and unrealized gains or losses on securities are recorded under other income.

General Allowance for Credit Risk

On October 22, 1998, the Superintendent of Financial Institutions issued a letter providing updated guidance on establishing general allowances for credit risk. It represents a further step in the program to strengthen general allowances and related methodologies.

The updated guidance was not prompted by a systemic problem of asset quality in the Canadian system. The need for higher general allowances was viewed to be supported by, amongst other things, the current position in the economic cycle, growing off-balance sheet activity and the associated credit risk as well as the levels of allowances of Canadian institutions compared to historic highs and to the situation of institutions abroad.

Beginning in 1999, the Superintendent will compare the level of the general allowance against selected assessment criteria.

Because of its very strong capital base, the Bank elected to act on the Superintendent's request immediately by adding a further $300 million to its general allowance, for a total of $500 million. The level of the general allowance was established by taking into consideration historical trends in the loss experience during an economic cycle, the current portfolio profile and estimated credit losses for the current phase of the economic cycle.

TABLE 3.4
Provision for Credit Losses
for the year ended October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Provision for credit losses					
Domestic					
Individuals and small businesses	58	100	115	69	64
Commercial	44	52	45	41	72
Corporate	2	17	4	34	31
Real Estate	10	60	26	33	41
Other	1	2	–	–	3
Domestic – Private risks	115	231	190	177	211
International					
Commercial – United States	44	10	5	4	19
Real Estate – United States	31	21	39	26	15
Real Estate – Other	–	–	(8)	–	2
Other	3	13	9	4	3
International – Private risks	78	44	45	34	39
General allowance for credit risk	–	100	–	44	25
Designated countries	–	(85)	–	–	–
Provision for credit losses charged to income	193	290	235	255	275
Net average loans and bankers' acceptances					
Domestic	35,550	32,671	29,424	28,382	26,462
International – United States	4,864	4,249	3,967	3,179	3,993
– Other	790	577	644	1,481	787
Total	41,204	37,497	34,035	33,042	31,242
Provision for credit losses as a percentage of net average loans and bankers' acceptances					
Domestic	0.32 %	0.71 %	0.65 %	0.62 %	0.80 %
International – United States	1.54 %	0.73 %	1.11 %	0.94 %	0.85 %
– Other	0.38 %	2.25 %	0.16 %	0.27 %	0.64 %
Total	0.47 %	0.77 %	0.69 %	0.77 %	0.88 %
Allowances					
Balance at beginning of year	839	751	792	819	868
Retroactive application of new accounting standard as at November 1, 1995	–	–	77	–	–
Provision for credit losses charged to income	193	290	235	255	275
Write-offs (1)	(328)	(242)	(364)	(313)	(345)
Recoveries	45	40	11	31	21
Adjustment to general allowance	300	–	–	–	–
Balance at end of year	1,049	839	751	792	819
Components of allowances:					
Designated countries					
Portion related to loans	40	52	69	85	85
Portion related to securities	17	4	85	105	105
Specific	492	583	497	502	573
General for credit risk	500	200	100	100	56

(1) Including exchange rate fluctuations.

Where the approach set out in the guidance results in a significant one-time adjustment to the level of the general allowance, the Superintendent, under the power conferred upon him by the Bank Act, specified that the adjustment be charged to retained earnings, with no restatement to opening retained earnings. Consequently, an amount of $183 million, representing the $300 million adjustment less deferred income taxes of $117 million, was charged to retained earnings.

Considering the amount required to conform to the guidance as well as the accounting treatment specified by the Superintendent, the accounting for the general allowance does not conform to generally accepted accounting principles in Canada. However, the accounting policies for all other financial statement items do conform, in all material respects, to generally accepted accounting principles as specified in the Auditors' Report.

The impact of the departure from Canadian generally accepted accounting principles to conform to the guidance provided by the Superintendent is as follows.

Impact of the adjustment on specific balance sheet items

The increase in the general allowance for credit risk changed the following items on the balance sheet:

(millions of dollars)	Increase (Decrease)
Assets	
Loans (net of allowances)	(300)
Other assets – Deferred income taxes	117
Shareholders' equity	
Retained earnings	(183)

Impact of the adjustment on book value

The adjustment of $183 million (i.e. $300 million less income taxes) reduced book value by $1.07 per share.

Impact of the adjustment on return on common shareholders' equity

The adjustment to the general allowance had no impact on return on common shareholders' equity for the fiscal year ended October 31, 1998. Indeed, the impact on average shareholders' equity was negligible as the charge to retained earnings was recorded on the last day of the fiscal year.

In subsequent fiscal years, the reduction in common shareholders' equity will improve the return on common shareholders' equity by approximately 1.1%.

Impact of the adjustment on capital ratios

The capital ratios determined in accordance with the rules of the Bank for International Settlements were reduced as a result of the adjustment to the general allowance and taking into account the granting of Tier 2 capital treatment for general allowances up to a maximum of 0.75% of risk-weighted assets. The table below shows the impact of this adjustment:

(millions of dollars)	Before adjustment	After adjustment
Tier 1 capital	3,320	3,137
Tier 2 capital	1,108	1,208
Total capital	4,428	4,345
Risk-weighted assets	40,830	40,647
Ratios		
Tier 1	8.1%	7.7%
Tier 2	2.7%	3.0%
Total	10.8%	10.7%

Impact of the adjustment on the Consolidated Statement of Income

The adjustment to the general allowance had no impact on the Consolidated Statement of Income.

Impact of the adjustment on the Consolidated Statement of Changes in Financial Position

The adjustment to the general allowance had no impact on the cash flows presented in the Consolidated Statement of Changes in Financial Position.

Operating Expenses

Operating expenses, half of which were comprised of salaries, fees and staff benefits, increased by 11.0% to $1,653 million. If the write-off of goodwill is excluded, the total is $1,589 million, for a 6.7% increase.

Excluding the write-off, more than 40% of the increase in operating expenses ($41 million of $100 million) was due to remuneration. However, these expenses grew much less rapidly than during the previous year (5.2% versus 10.8%) because of the slowdown in activity at Lévesque Beaubien Geoffrion.

Furthermore, the increase in expenses under the heading "Premises, computers and equipment", which accounted for $28 million of the total increase in operating expenses, was contained at 8.1%, as against 9.5% in 1997.

The increase was wholly attributable to the leasing and maintenance of information technology systems.

The productivity ratio (i.e. the ratio of operating expenses to gross income) went from 62.6% to 67.4%, essentially because of the write-off of goodwill and lower expenses at Lévesque Beaubien Geoffrion. Had it not been for these two factors, the productivity ratio would have gone from 59.1% to 60.6%.

Income Taxes

In 1998, income taxes amounted to $256.4 million, which corresponds to the $259.2 million stated in Table 3.1 adjusted to the taxable equivalent basis. Detailed information on income tax is presented in Note 14 to the consolidated financial statements on page 61.

MOVING TOWARDS THE YEAR 2000

The "millennium bug" or "Y2K bug" refers to the common practice in many older software programs and microprocessors of identifying the year using only two digits. As a result, the Year 2000 will be represented by "00" in such systems. This practice can cause calculation errors, affect the integrity of the data being processed and impact certain operations. As a result, software which is not Year 2000 compliant would not be able to accurately calculate time periods by subtracting the start date from the end date. When computing the number of years between January 1, 1999 and January 1, 2000, for instance, the answer would be negative (i.e. 00-99 = -99 years).

As financial institutions, the Bank and its subsidiaries are particularly vulnerable to the millennium bug because of the widespread use they make of information technologies both in their business operations and in administration. For example, most transactions with clients are computerized and involve time periods and maturities in order to calculate interest, etc. Analysis, recording and monitoring of financial market operations also require systems to calculate time periods. Moreover, certain aspects of the problem are beyond the Bank's control because they involve third parties such as clients, suppliers, business partners or other financial institutions.

Task Forces

As early as 1996, the Bank, well aware of the need to analyze its computer systems and resolve any Year 2000 problems, set up a task force – the National Bank 2000 team – to address this issue. The team was given the mandate to mobilize the necessary resources to identify and correct incompatible systems and ensure that the Bank's operations and customer service could continue without interruption. The National Bank 2000 team reports directly to a committee comprised of members of Senior Management.

The team, made up of a number of specialists, was allocated a budget of $35 million for its analysis and coordination activities between 1997 and 2000. Total costs as at October 31, 1998 were $22 million, and Management anticipates further expenses of $13 million by 2000. In compliance with generally accepted accounting principles, expenses incurred during a given fiscal year to correct the Y2K issue are recorded in the results for that year.

In fall 1997, the subsidiary Lévesque Beaubien Geoffrion set up its own task force, the LBG 2000 team. The problem of transition to the Year 2000 is somewhat different in the securities industry, notably because of coordination with stock exchanges. The total budget for the Year 2000 operation at Lévesque Beaubien Geoffrion is $5.1 million, about 40% of which had been spent as at October 31, 1998.

Timetable

The National Bank 2000 project called for defining analysis standards and procedures, establishing an inventory of systems susceptible to the millennium bug, identifying systems to be modified or replaced, carrying out pilot tests and converting all non-compliant systems. By the end of December 1998, not only will most systems have been upgraded for the Year 2000, but most will also have undergone individual compliance tests.

Once a system has passed these tests, it is certified compliant with the Year 2000 standards established by the Bank. As at October 31, 1998, almost all of the Bank's equipment and over 70% of its systems had been certified. By the end of the first quarter of 1999, the few remaining systems that were not compliant should be certified in the final tests.

In order to ensure that a system remains compliant with the Bank's standards after it has been certified, a certification maintenance process will continue until the Year 2000.

Starting in summer 1999 and continuing until year end, critical systems will undergo comprehensive trials in a Year 2000 environment. At the same time, during the critical period from mid-1999 to March 2000, a moratorium will be imposed on new systems and on modifications to compliant systems.

Despite all the precautions taken, should any problem have been overlooked, a contingency plan to be finalized early in 1999 will provide for the implementation of backup systems and relevant operating procedures.

The LBG 2000 team is conducting a similar process, factoring in the specific conditions applicable to the securities industry. All critical systems at Lévesque Beaubien Geoffrion will have been certified compliant with the standards established by LBG by the end of the first quarter of 1999 and will be the object of ongoing testing until September 1999, including tests with stock exchanges. Preparation of a contingency plan will also be completed by the end of the first quarter of 1999.

Impact and Corrective Measures

All information technology systems at the Bank and its subsidiaries, as well as related forms and documents, are potentially susceptible to the millennium bug. They will undergo the analysis and certification process described above, even though the most recent software and equipment are usually already configured for the next millennium.

In February 1998, the National Bank had its processes – including those pertaining to LBG – validated by an independent consulting firm, which concluded that they satisfied most of the performance indicators related to the success criteria. The necessary measures were taken in response to the consultants' recommendations and comments.

The measures adopted will help to ensure that it will be business as usual at the Bank and its subsidiaries in the Year 2000. Should any unexpected problems arise, then the contingency plans in place at the Bank and at Lévesque Beaubien Geoffrion should make it possible to maintain key services and ensure their accessibility, just as they did during the ice storm that paralyzed much of Eastern Canada in January 1998.

Another possibility that had to be considered was that the millennium bug could affect suppliers and clients and thereby have an indirect impact on the operations of the Bank and its subsidiaries. For this reason, the Bank took steps to request assurances from its main suppliers that their own systems were Y2K compliant. This activity will continue, extending eventually to all of the Bank's suppliers.

The Bank has also introduced special programs to ensure that commercial clients work to minimize their risks in the transition to the Year 2000, so that the credit risk they represent for the Bank does not increase. All large corporate clients as well as independent businesses above a certain size have been asked to complete a form to enable the Bank to assess potential risk and monitor the situation (quarterly in the case of independent businesses). Furthermore, the Bank has distributed information to all its commercial clients on the risks associated with the millennium bug. Bank representatives have addressed the issue in many talks to the general public, not to mention the special meetings organized by commercial banking centres in various regions. When necessary, clients are referred to resources that will assist them in achieving Year 2000 readiness. Since summer 1998, the Bank's Web site (www.nbc.ca) has had a special Year 2000 section offering helpful information.

In the opinion of Management, the Bank has adopted measures which serve to minimize the uncertainty and risk associated with the transition to the Year 2000. Its approach of keeping its commercial clients informed and following up on them allows the Bank to believe that neither the credit risk of its portfolio nor its results will be materially affected by the arrival of the Year 2000. However, Management cannot be certain that the transition to the Year 2000 will not cause any inconvenience, particularly in light of factors that are beyond its control and which depend on the diligence of clients, suppliers and other third parties.

TABLE 3.5
Operating Expenses
for the year ended October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Salaries and staff benefits	822	781	705	637	642
Premises, computers and equipment, including amortization	374	346	316	293	249
Other expenses					
Messenger services and communications	60	57	55	50	45
Advertising and external relations	37	31	32	27	29
Stationery	21	19	16	14	14
Loan and deposit insurance	38	40	37	36	30
Professional fees	69	66	48	42	39
Travel expenses	13	11	11	11	12
Security and theft	11	10	12	10	13
Capital and payroll taxes	50	48	48	39	30
Reduction in value of assets	64	–	56	–	–
Other	94	80	77	70	65
	457	362	392	299	277
Total	1,653	1,489	1,413	1,229	1,168
Domestic	1,565	1,414	1,336	1,162	1,105
International – United States	70	55	56	49	46
– Other	18	20	21	18	17
Total expenses as a percentage of total income	67.4%	62.6%	66.9%	65.0%	64.4%
Excluding the reduction in value of assets	64.8%	62.6%	64.3%	65.0%	64.4%
Excluding Lévesque Beaubien Geoffrion	60.6%	59.1%	61.6%	62.3%	61.9%

ANALYSIS OF FINANCIAL CONDITION

Assets

Total assets stood at $70,663 million as at October 31, 1998, a record amount which corresponds to a 6.7% advance over the previous year.

Table 3.6 presents the sources of asset growth. The increase in the securities portfolio more than offset the reduction in securities purchased under resale agreements. The rise in business and government loans outstanding (+$2,027 million), combined with higher bankers' acceptances (+$385 million), accounted for more than half of the total increase. A further one quarter of this growth was generated by the rise in residential mortgages (+$1,278 million).

As at October 31, 1998, the Bank's portfolio contained $44,095 million of loans and bankers' acceptances, excluding securities purchased under resale agreements. This represents an advance of $3,718 million or 9.2% over fiscal 1997.

The strong growth in business loans and bankers' acceptances can be traced to the Bank's ability to continue expanding both its commercial lending activities in the United States and its market shares in Quebec, despite fierce competition.

Residential mortgages represented more than one third of the lending portfolio. The Bank increased its market share of this sector where the very intense level of competition exerts considerable pressure on profitability. The residential mortgage portfolio posted growth of 9.8% overall. Certain markets grew much faster, such as the Ontario market served by the Toronto Mortgage Centre, which recorded 25% growth.

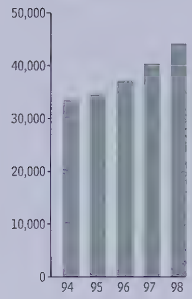
TABLE 3.6
Asset Growth
as at October 31
(millions of dollars)

	1998		1997	
	$	%	$	%
Total assets	70,663		66,235	
Growth during the year	4,428	7	13,101	25
Components of growth:				
Cash resources	376	8	948	27
Securities	4,562	46	1,596	19
Loans				
Residential mortgages	1,278	10	783	6
Personal and credit cards	28	–	566	11
Business and government	2,027	11	1,517	9
Securities purchased under resale agreements	(4,208)	(46)	6,458	239
Customers' liability under acceptances	385	17	548	32
Other	(20)	(1)	685	45

Personal loans outstanding (mainly consumer loans and credit card advances) amounted to $5,976 million. The sluggish 0.5% growth in 1998 was attributable to the securitization of a $500 million portfolio of credit card receivables, as well as fierce competition in this sector. Indirect budget loans, sold through merchants such as car dealers, recorded significant growth. They were the highest growth segment of personal loans.

The geographic distribution of earning assets as at September 30, 1998 (see Table 3.7) remained essentially unchanged from the corresponding date of 1997. The only significant differences were an increase in the proportion of earning assets in Europe (from 5.4% to 7.0%) as well as in Latin America and the Caribbean (from 0.9% to 2.3%). A transaction involving securities purchased under resale agreements in Bermuda and the transfer of securities from Singapore to the Bahamas primarily accounted for the rise in earning assets in Latin America and the Caribbean.

Loans and bankers' acceptances (1)
(millions of dollars)



(1) Excluding securities purchased under resale agreements

Funding

The Bank finances its lending and investment activities through funds obtained from its depositors, investors and shareholders. Acting as an intermediary between lenders and borrowers, between savers and investors, constitutes the traditional business of a bank. To do so successfully, it must be financially sound. For instance, a bank must manage its liquidity in such a way as to meet its day-to-day financial obligations. Activities must be funded at the lowest possible cost and with maximum efficiency. It must also maintain a solid capital base that will safeguard it against any economic or financial eventuality.

As at October 31, 1998, the Bank's balance sheet contained $19,424 million of cash resources and securities compared to $14,486 million a year earlier. Securities represented three quarters of this amount with cash resources (especially deposits with other banks) making up the remainder. Cash resources and securities amounted to 27.5% of total assets, up from 21.9% at the end of fiscal 1997.

Deposits

The Bank funded approximately 68% of its assets through deposits. As at October 31, 1998, personal deposits accounted for 41.4% of the deposit mix, commercial deposits for 20.5% and purchased funds (primarily deposits by other financial institutions) for 38.1%, as shown in Table 3.8. Total deposits at the Bank amounted to $48,026 million, for an increase of 11.0%.

TABLE 3.7

Geographic Distribution of Earning Assets by Ultimate Risk (1)

as at September 30
(millions of dollars)

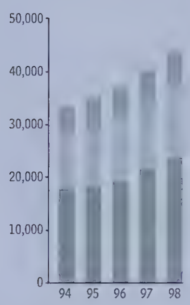
	1998		1997		1996		1995		1994	
	$	%	$	%	$	%	$	%	$	%
North America										
Canada	52,268	78.6	44,993	80.0	39,622	81.9	38,122	79.0	34,180	80.1
United States	7,611	11.4	6,323	11.3	4,209	8.7	4,385	9.1	5,141	12.0
	59,879	90.0	51,316	91.3	43,831	90.6	42,507	88.1	39,321	92.1
Europe										
United Kingdom	1,745	2.6	1,342	2.4	1,408	2.9	1,646	3.4	1,353	3.2
France	933	1.4	554	1.0	464	1.0	966	2.0	251	0.6
Germany	455	0.7	302	0.5	266	0.6	454	0.9	93	0.2
Switzerland	230	0.3	16	–	14	–	14	–	50	0.1
Other	1,309	2.0	844	1.5	626	1.3	827	1.8	467	1.1
	4,672	7.0	3,058	5.4	2,778	5.8	3,907	8.1	2,214	5.2
Latin America and Caribbean	1,516	2.3	533	0.9	363	0.8	397	0.8	286	0.7
Asia and Pacific										
Japan	35	0.1	76	0.1	258	0.5	393	0.8	90	0.2
Other	359	0.5	1,205	2.2	1,022	2.2	1,022	2.1	738	1.7
	394	0.6	1,281	2.3	1,280	2.7	1,415	2.9	828	1.9
Middle East and Africa	52	0.1	48	0.1	46	0.1	45	0.1	36	0.1
Earning assets as at September 30	66,513	100.0	56,236	100.0	48,298	100.0	48,271	100.0	42,685	100.0
Other assets as at September 30	4,707		4,263		3,511		3,058		2,929	
Net change in assets in October	(557)		5,736		1,325		(2,416)		(840)	
Total assets as at October 31	70,663		66,235		53,134		48,913		44,774	

(1) Earning assets are those which bear interest. Consequently, they do not include cash resources, deposits with the Bank of Canada, cheques and other items in transit (net value), fixed assets, other assets and customers' liability under acceptances. The Bank's earning assets as at September 30 were distributed according to the location of ultimate risk, namely, the geographic location of the borrower or, if applicable, the guarantor. Earning assets are calculated net of any general or specific allowances and are presented separately for each country where the Bank's exposure exceeds an amount equal to 3/4% of total earning assets.

TABLE 3.8
Deposits
as at October 31
(millions of dollars)

	1998		1997		1996		1995		1994	
	$	%	$	%	$	%	$	%	$	%
Personal	19,897	41.4	20,413	47.2	22,413	55.9	21,389	52.9	20,172	54.7
Commercial	9,828	20.5	7,709	17.8	7,056	17.6	6,411	15.9	5,599	15.2
Purchased funds	18,301	38.1	15,148	35.0	10,656	26.5	12,624	31.2	11,079	30.1
	48,026	100.0	43,270	100.0	40,125	100.0	40,424	100.0	36,850	100.0
Domestic	30,886	64.3	29,158	67.4	32,471	80.9	30,197	74.7	28,357	77.0
International – United States	6,292	13.1	5,474	12.6	3,597	9.0	3,359	8.3	3,359	9.1
– Other	10,848	22.6	8,638	20.0	4,057	10.1	6,868	17.0	5,134	13.9
	48,026	100.0	43,270	100.0	40,125	100.0	40,424	100.0	36,850	100.0
Personal deposits as a percentage of total assets		28.2		30.8		42.2		43.7		45.0

Business and personal loans (millions of dollars)



Personal deposits continued to decline, although at a slower pace than in 1997 (-2.5% versus -8.9%). The reason for this downward trend, which the Bank discussed in its 1997 annual report, is that individuals are often attracted to savings instruments offering a higher potential yield, such as mutual funds and other forms of stock market investments.

Because of its diversification into these other financial sectors, the Bank was able to provide its clients with the savings substitutes they prefer. Although deposits outstanding at the Bank were down some $500 million in 1998, the value of assets under administration or management for this client group rose by $4.2 billion.

While personal deposits may have fallen overall, that was not the case for the subcategory "Transaction deposits" which continued to grow in the order of 2.2% in 1998. This phenomenon clearly illustrates that, in the field of payments, the banks still have an indispensable role to play.

Commercial deposits again advanced strongly, up 27.5% in 1998 compared to 9.3% in 1997. As a result of growth in commercial deposits, core deposits (personal plus commercial) were up 5.7% to $29,725 million as at October 31, 1998. The ratio of core deposits to total deposits continued to decline, from 65.0% to 61.9%.

To fund the expansion of its business lending activities, the Bank had to raise its volume of purchased funds (i.e., deposits obtained on financial markets, generally from other financial institutions). Purchased funds represented 38.1% of total deposits at year end.

Capital

As at October 31, 1998, the Bank's total capital stood at $4,184 million. Table 3.9 presents the sources of this capital.

Capital is obtained through external financing (debenture and share issues) and from internally generated capital, or earnings not paid out as dividends. During the year, the Bank raised the dividend on common shares from 57.5¢ to 66¢. Thus, before the adjustment to the general allowance, internally generated capital would have totalled $159 million, which approximates net income of $316 million less the dividend payout of $140 million.

However, the addition of $300 million to the general allowance, taken from shareholders' equity, reduced internally generated capital by $183 million after taxes (which amount is included in the $200 million appearing under "Other items affecting retained earnings"). Internally generated capital in 1998 was therefore a negative amount of $24 million.

External financing was also negative because of the redemption of certain bank debentures and of the Series 5, 7 and 8 Preferred Shares. The Bank issued some $18 million of common shares primarily under its employee profit-sharing plans.

In all, total capital was down slightly, by $111 million or 2.6%, from its record high in 1997.

Table 3.10 provides particulars on the Bank's regulatory capital. Tier 1 capital grew by 4.1%, a relatively modest rise owing primarily to the impact on common shareholders' equity of increasing the general allowance. Tier 2 capital was up by a very small amount, since the reduction in cumulative preferred shares and debentures outstanding was offset by the increase in the general allowance (up to 0.75% of risk-weighted assets can be included in Tier 2 capital). Total regulatory capital rose by 3.1% to $4,345 million as at October 31, 1998.

Further to the new valuation standards introduced by the Superintendent of Financial Institutions, securities in the trading portfolio are now considered a market risk and are valuated accordingly. The credit equivalent of securities was therefore reduced and a new item was created, to which $1,195 million was posted as at October 31, 1998.

The lower half of Table 3.10 presents the value of balance sheet and off-balance sheet items, risk-weighted according to the rules of the Bank for International Settlements. Calculated by dividing Tier 1 and total capital by total risk-weighted assets, the Bank's Tier 1 capital ratio was 7.7% as at October 31, 1998, and its total capital ratio was 10.7%. Both ratios were down slightly from the 8.1% and 11.3% respectively recorded at year end 1997.

These developments must be considered in light of the robust growth in the total capital ratio in 1997, and the fact that the National Bank is still one of the best capitalized banks among the major Canadian banks.

Assets Under Administration/Management

Table 3.11 lists the principal asset administration and management services which the National Bank and its subsidiaries offer to clients. As at October 31, 1998, the value of these assets amounted to $72,136 million, for an increase of 8.3%. With the exception of mortgages sold to third parties, all management and administration categories contributed to this growth.

TABLE 3.9
Source of Capital
as at October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Non-controlling interest	523	466	42	36	44
Bank debentures	966	1,069	1,016	1,177	1,241
Shareholders' equity					
Preferred shares	317	376	376	376	532
Common shares	1,327	1,309	1,268	1,234	1,207
Retained earnings	1,051	1,075	855	701	578
	2,695	2,760	2,499	2,311	2,317
Total capital	4,184	4,295	3,557	3,524	3,602
Internally generated capital					
Net income	316	342	318	245	217
Other amounts affecting retained earnings	(200)	2	(56)	(18)	1
	116	344	262	227	218
Less: dividends	(140)	(124)	(108)	(104)	(102)
	(24)	220	154	123	116
External financing					
Non-controlling interest	57	424	6	(8)	3
Debentures	(103)	53	(161)	(64)	204
Preferred shares	(59)	–	–	(156)	106
Common shares	18	41	34	27	124
	(87)	518	(121)	(201)	437
Increase (Decrease) in capital	(111)	738	33	(78)	553

The Bank was more than able to make up for the approximate $500 million decline in personal deposits in 1998 in the form of other savings instruments. If InvesNat and non-proprietary mutual funds sold by National Bank Securities, stock portfolios held by individual clients of Lévesque Beaubien Geoffrion and the InvesTel discount brokerage service are isolated from the data in Table 3.11, the amounts flowing through the National Bank group in 1998 were up some $4.2 billion over the previous year.

TABLE 3.10
Capital Ratios
as at October 31
(millions of dollars, in accordance with BIS guidelines)

	1998	1997	1996[2]	1995	1994
Tier 1 capital					
Common shareholders' equity	2,378	2,384	2,123	1,935	1,785
Non-cumulative permanent preferred shares	317	317	317	317	442
Non-controlling interest	523	466	42	36	44
Less: goodwill	(81)	(154)	(161)	(159)	(169)
	3,137	3,013	2,321	2,129	2,102
Tier 2 capital					
Cumulative preferred shares	–	59	59	59	90
Bank debentures	911	947	1,064	1,078	1,184
General allowance	300	200	–	–	–
Less: investments in affiliated corporations	(3)	(3)	(1)	(1)	(1)
	1,208	1,203	1,122	1,136	1,273
Total capital	4,345	4,216	3,443	3,265	3,375
Risk-weighted balance sheet items					
Cash resources	882	981	761	1,019	805
Securities	583	2,282	2,861	2,334	2,230
Mortgage loans	4,335	4,200	4,156	4,118	4,029
Other loans	26,839	24,475	20,143	19,144	18,412
Other assets	1,771	1,749	3,098	2,500	2,542
	34,410	33,687	31,019	29,115	28,018
Risk-weighted off-balance sheet items[1]					
Commitments to extend credit					
Guarantees, letters of credit and transaction-related contingencies	1,645	1,193	1,174	1,121	978
Other commitments to extend credit	2,819	2,293	1,358	1,086	1,250
Interest rate contracts	94	77	66	38	21
Foreign exchange contracts	443	158	136	197	145
Equity contracts	41	18	21	–	–
Commodity contracts	–	–	–	–	–
	5,042	3,739	2,755	2,442	2,394
Market risk items	1,195	–	–	–	–
Total risk-weighted assets	40,647	37,426	33,774	31,557	30,412
Ratios					
Tier 1	7.7 %	8.1 %	6.9 %	6.8 %	6.9 %
Tier 2	3.0 %	3.2 %	3.3 %	3.6 %	4.2 %
Total	10.7 %	11.3 %	10.2 %	10.4 %	11.1 %

(1) As at September 30.
(2) Taking into account the issue of $150 million in debentures on November 1, 1996.

TABLE 3.11
Assets Under Administration/Management
as at October 31
(millions of dollars)

	General Trust of Canada	Lévesque Beaubien Geoffrion	National Bank Securities	Natcan Investment Management	NBC Clearing Services	Bank excluding subsidiaries	Total 1998	Total 1997
Assets under administration								
Institutional	25,533	–	–	–	238	–	25,771	24,384
Personal	–	23,539	2,805	–	–	–	26,344	22,778
Mutual funds	2,256	4	3,021	–	–	–	5,281	5,193
Mortgage loans sold to third parties	27	–	–	–	–	1,045	1,072	1,421
Total assets under administration	27,816	23,543	5,826	–	238	1,045	58,468	53,776
Assets under management								
Personal	2,787	–	–	–	–	–	2,787	2,389
Managed portfolios	–	620	1,477	5,528	–	–	7,625	7,335
Mutual funds	–	–	–	3,256	–	–	3,256	3,109
Total assets under management	2,787	620	1,477	8,784	–	–	13,668	12,833
Total	30,603	24,163	7,303	8,784	238	1,045	72,136	66,609

RISK MANAGEMENT

Risk is an inherent feature of banking intermediation and financial products, and managing that risk is one of a bank's main responsibilities. This section contains a description of the various types of risk affecting the Bank's operations and the control methods and procedures used by the Bank, an analysis of the Bank's balance sheet as at October 31, 1998 in terms of credit and interest rate risk, and an analysis of the risk in off-balance sheet activities (notably derivatives) as at that date.

CONTROLLING RISK

Credit risk, market risk and liquidity risk are the three main risk categories. In addition, there are legal risks and risks associated with operations.

The risk related to a specific financial instrument (debt security or other type of security) is managed using a portfolio approach: the instrument is considered a component of a portfolio that contains other balance sheet and off-balance sheet items.

Credit Risk

Credit risk is the risk that a loss may occur if the counterparty fails to honour its commitments with respect to a financial instrument. It applies to both balance sheet and off-balance sheet assets, such as a loan or a derivative with a positive market value.

Credit risk is controlled using detailed policies which are designed to maximize the risk/return trade-offs. These policies are approved by the Board of Directors.

The Bank's credit risk management policy for balance sheet items is adopted by the Board of Directors in collaboration with the Executive Office and the Credit Committee of the Board. It sets out the objectives and the methods and procedures for identifying and measuring risks (including concentration risk), evaluating credit, approving applications, as well as checking, monitoring and controlling such risk.

The Chief Executive Officer and the Chair of the Credit Committee of the Bank (a separate entity from the Credit Committee of the Board) are responsible for implementing these measures. Line management with the authority to approve credit applications varies in accordance with the size and risk of the loan being contemplated. Beyond certain limits, the decisions are made by the Credit Committee of the Board. Each credit application must meet the requirements stipulated in the Bank's policy. The portfolio is monitored on an ongoing basis and a specialized team analyzes the risks associated with the various credit categories and sectors in which the Bank wants to be involved.

At least once a year, the Chair of the Credit Committee of the Bank presents a detailed risk management report to the Board of Directors. Periodic and special reports are also submitted to the Board of Directors, the Executive Committee and the Credit Committee of the Board. Accounts which could become problematic are monitored very closely and independent examinations are conducted.

Market Risks: Interest and Foreign Exchange Rates

Market risks are related to the probability of variations in the value of a financial instrument because of fluctuations in economic conditions and market prices. For a bank, the main market risks are tied to changes in interest and currency rates.

"Foreign currency risk" or "foreign exchange risk" refers to the impact of exchange rate movements on the value of a financial instrument.

"Interest rate risk" designates the risk that the value of a balance sheet or off-balance sheet financial instrument will be affected by market variations in interest rates. In the balance sheet, interest rate risk results from the mismatching of the maturities of assets and liabilities. To control this risk, the Bank manages its asset and liability matching and adjusts the mix of its portfolios by using a vast range of both balance sheet and off-balance sheet financial instruments, including securitization transactions.

The Board of Directors has established specific, detailed policies for controlling market risks. These policies are aimed not at neutralizing such risks, but at maximizing risk/return trade-offs within carefully defined limits.

Market risks are evaluated and managed by the Treasury sector, primarily using a VAR (value at risk) methodology. With a simulation model, it is possible to estimate the impact of potential market fluctuations on the financial instruments held by the Bank. The model concentrates on worst-case loss scenarios and excludes only those risks with a probability of less than 1% over a 10-day period. In addition to daily VAR simulations, at least once a week the Bank carries out a simulation aimed at gauging the impact of catastrophic events that exceed the 99% confidence level. This stress testing is used to measure – and if necessary mitigate – the Bank's vulnerability to extreme shifts in market conditions.

The Bank also uses other risk measurement methods as part of its internal control operations. Measuring the day-to-day volatility of profits and losses, which is key to ensuring that the limits set for market risk are respected, is used in conjunction with other standard financial risk measurements and various sensitivity analysis techniques.

The Executive Committee of the Board of Directors establishes maximum risk limits and the procedures to follow depending on the level of risk involved. Responsibility for managing market risks lies with the President of the Financial Markets, Treasury and Investment Bank. Managers are required to respect strict follow-up and reporting procedures, and stop-loss mechanisms are automatically triggered should losses at any time exceed certain specified levels. Moreover, an independent unit within the Bank is responsible for monitoring and controlling transactions.

Liquidity Risk

Liquidity risk refers to an institution's ability to raise the funds needed to meet its financial commitments, whether for balance sheet items or off-balance sheet activities. An integral part of asset and liability management, liquidity risk is included in the strategies applied by Treasury. Since it is extremely important for a bank to have liquid assets available at all times, special emphasis is placed on managing them.

The Bank's liquidity management policy, which is approved by the Board of Directors, sets out the objectives, measurement methods, minimum requirements and control procedures for liquid assets as well as strategies for obtaining market funds and the steps to be taken to deal with any unforeseen events. The President of the Financial Markets, Treasury and Investment Bank is responsible for applying the liquidity management policy, a report on which is submitted each year to the Executive Office. The situation is regularly monitored through weekly follow-up reports on liquidity ratios and quarterly reports on the Bank's overall liquidity position.

The liquidities needed for the Bank's operations are guaranteed by stable, well-diversified funding through core deposits and purchased funds, capital adequacy, and the Bank's access to capital markets. Other techniques, such as loan syndication and securitization, the marketing of Bank products and the use of derivatives, are also instrumental in matching assets and liabilities which in turn ensures sufficient liquidity.

Operational Risk

Operational risk concerns the possibility that losses would be incurred should information systems or operations control and management systems fail. The Bank has a number of ways to limit this risk exposure. For example, it establishes specific policies and procedures, including emergency plans (for recovery in the event of equipment breakdown, for instance), continuous monitoring and follow-up of procedures and systems, daily backup of transactions, regular presentation of reports to senior line management, separation of transaction and control functions, and personnel training.

Analysis of Balance Sheet Risks

Credit and interest rate risks represent the main risks for financial instruments on the balance sheet.

Credit Risk Management

During the year ended October 31, 1998, the Bank continued to apply very strict credit limits and procedures and further refined its decision support systems. In the commercial sector, use of the RAROC capital allocation model ensures that credit terms and conditions more accurately correspond to the risks inherent in the credits granted. The Bank continues to carry out syndication activities in order to spread the risk in certain loans among several financial institutions. Syndication, which helps meet the needs of borrowers while reducing risk for lenders, is now carried out at a global level as it has expanded beyond regional and national boundaries.

As shown in Table 3.4 (page 24), this strategy has been successful as the Bank was able to substantially lower its provision for credit losses set aside for small and medium-sized enterprises and corporations in 1998.

RAROC MODEL

The RAROC (Risk-Adjusted Return on Capital) model is a financial analysis tool designed to ensure the most efficient allocation of capital by comparing returns for each of the Bank's constituent parts and the capital they use.

In the RAROC methodology, the risk which a borrower represents is calculated according to a number of variables: the borrower's credit rating, which serves to estimate the probability of non-payment; the loan term, which is used to take into account the uncertainty regarding the borrower's future creditworthiness; the collateral pledged by the borrower; the risk of drawdowns on credit commitments; and portfolio diversification.

The model assigns an expected loss to each credit facility based on average rates of default. Default rates are calculated over the entire economic cycle in order to avoid underestimating the credit risk during periods of robust growth. The allocation of capital is determined in such a way as to ensure adequate coverage of losses in 99.9% of cases. The foundations of the RAROC methodology for allocating capital based on credit risk are the same as those for the VAR method applied to market risk.

In addition to allowing better management of credit risk, the RAROC method is much more accurate in measuring the profitability of the Bank's products, commercial operations, client segments and business units.

Although this methodology is used worldwide, it nevertheless has to be customized to each financial institution. The type of model developed at the National Bank is expected to replace the risk-weighted capital measurement provided by the Bank for International Settlements. With its methods already on the cutting edge of the industry, the Bank is ready for this transition.

Table 3.12 illustrates the diversity of the Bank's loan portfolio. Nearly 30% of outstanding loans are residential mortgages, 12% are personal loans (primarily consumer loans, credit cards and certain loans to small businesses) while the remainder are mainly business loans. These loans are made to businesses in every sector of the economy and represent close to half of the Bank's portfolio, the highest proportion of any bank in Canada.

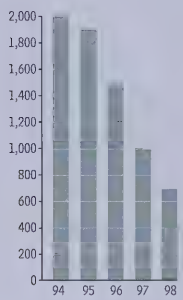
TABLE 3.12
Distribution of Loans by Borrower Category
as at September 30
(millions of dollars)

	1998		1997		1996		1995		1994	
	$	%	$	%	$	%	$	%	$	%
Personal (1)	5,975	12.1	5,870	14.0	5,330	14.1	5,307	15.0	5,243	15.8
Residential mortgage	14,158	28.8	12,998	30.9	11,550	30.5	10,904	30.9	10,196	30.7
Non-residential mortgage	648	1.3	699	1.7	608	1.6	781	2.2	835	2.5
Agricultural	942	1.9	847	2.0	713	1.9	689	2.0	635	1.9
Financial institutions	2,268	4.6	2,436	5.8	1,773	4.7	767	2.2	1,296	3.9
Manufacturing and industrial	5,076	10.3	3,786	9.0	3,422	9.0	3,480	9.9	2,909	8.8
Construction and real estate	2,194	4.5	2,158	5.1	2,501	6.6	2,728	7.7	2,597	7.8
Transportation and communications	815	1.7	655	1.6	574	1.5	688	1.9	567	1.7
Mines, quarries and energy	614	1.3	398	0.9	334	0.9	307	0.9	236	0.7
Forestry sector	269	0.5	252	0.6	242	0.6	264	0.7	346	1.0
Governments and other public agencies	724	1.5	557	1.3	520	1.4	488	1.4	445	1.3
Wholesale trade	1,431	2.9	1,346	3.2	1,209	3.2	1,216	3.4	1,193	3.6
Retail trade	1,729	3.5	1,293	3.1	1,221	3.2	1,377	3.9	1,339	4.0
Services	2,818	5.7	2,241	5.3	2,200	5.8	2,003	5.7	2,130	6.4
Securities purchased under resale agreements	6,812	13.8	4,133	9.8	3,062	8.1	2,313	6.6	1,467	4.4
Other	2,779	5.6	2,406	5.7	2,591	6.9	1,996	5.6	1,769	5.5
	49,252	100.0	42,075	100.0	37,850	100.0	35,308	100.0	33,203	100.0

(1) Includes consumer loans, credit cards and other personal loans.

The distribution of loans among the various sectors of the economy has not changed significantly from fiscal 1997. The Bank constantly monitors developments in the economic sectors in which its clients operate and, at the first warning sign, carries out simulations to evaluate the impact of various scenarios and to adapt its policies accordingly.

Net real estate loans
(millions of dollars)



The Bank continued its orderly withdrawal from the real estate market in 1998. Gross real estate loans amounted to $811 million as at October 31, 1998, down 31.9% from a year earlier (Table 3.13). Less the $116 million in provisions set aside to cover potential losses in this sector, net volumes outstanding were $695 million, for a decrease of 32.7% from the previous year.

Real estate loan volumes shrank in every region this year. We took advantage of good opportunities as they arose to sell or restructure domestic real estate loans, with the result that gross volumes declined by 29.3%. At the same time, we continued to liquidate the U.S. real estate portfolio, reducing gross loans outstanding by $154 million or 36.8% by the end of the year.

As can be seen from the breakdown of loans by type of project, real estate volumes declined in virtually all sectors.

Net real estate exposure represented only 26% of shareholders' equity at year end, compared to 37% in 1997 and 88% in 1994. It also dropped to 1% of total loans and bankers' acceptances.

The volume of loans to designated countries is now negligible, as shown in Table 3.14. The $57 million provision represents more than half of the gross value of these loans. Net outstandings amounted to $56 million, or only 2.1% of shareholders' equity.

Provisioning rate of private-risk loans
(as a percentage)

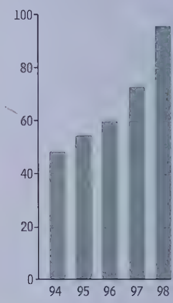


TABLE 3.13
Real Estate Loans
as at October 31
(millions of dollars)

	1998		1997		1996		1995		1994	
	$	%	$	%	$	%	$	%	$	%
Geographic distribution										
Canada										
Ontario	238	29	327	28	437	27	491	24	570	26
Quebec	287	35	405	34	503	31	562	27	494	22
Other	21	3	40	3	34	2	57	3	101	4
	546	67	772	65	974	60	1,110	54	1,165	52
United States										
California	79	10	149	13	232	15	302	14	329	15
New York	27	3	63	5	96	6	118	6	131	6
Illinois	28	4	55	4	114	7	144	7	149	7
Other	131	16	152	13	194	12	262	13	327	15
	265	33	419	35	636	40	826	40	936	43
Other	–	–	–	–	–	–	116	6	121	5
	811	100	1,191	100	1,610	100	2,052	100	2,222	100
By type of project										
Retail	233	29	358	30	414	26	511	25	531	24
Office	254	31	410	34	572	36	815	40	974	44
Residential	71	9	158	13	188	11	214	10	243	11
Industrial	78	10	78	7	110	7	157	8	173	8
Land	37	4	35	3	47	3	64	3	43	2
Other	138	17	152	13	279	17	291	14	258	11
	811	100	1,191	100	1,610	100	2,052	100	2,222	100
Allowances for credit losses	116		158		116		153		173	
Real estate loans, net	695		1,033		1,494		1,899		2,049	
As a percentage of shareholders' equity		26		37		60		82		88
As a percentage of total loans and bankers' acceptances		1		2		4		5		6

Even before the crisis in Asia began to unfold in the summer of 1997, the Bank had pared down its assets substantially in that region. The Bank's asset volume in those countries amounted to no more than $150 million at fiscal year end 1998. Its assets in emerging economies hit hard by the turmoil at the end of fiscal 1998 are either nil (Russia) or very low (some $225 million in Latin America). As a result, the Bank incurred few losses.

In 1998, net impaired loan volumes dropped sharply from $297 million to $47 million.

Although it is true that in Canada, net impaired loans were up in the personal banking and SME sectors (+1.2% and +13.7% respectively), they nevertheless continued to decline in the real estate sector and were reduced to zero in the Corporate Banking sector.

Impaired loans, net of specific provisions, rose in the international sector. This increase was confined mainly to the U.S. commercial sector and was attributable to this portfolio's exceptional performance in recent years.

As a percentage of the $1,037 million in gross private impaired loans, the $992 million allowance taken as at October 31, 1998 represented a provisioning rate of 95.7%. As a proportion of common shareholders' equity, net impaired loans were down significantly to 2.0%.

TABLE 3.14
Designated Countries
as at October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Loans and securities, gross					
Poland	–	–	–	90	91
Brazil	39	35	51	91	91
Argentina	–	–	51	51	51
Ivory Coast	14	18	18	18	18
Venezuela	–	–	15	15	15
Sudan	18	16	17	19	17
Morocco	–	–	–	28	28
Peru	14	13	22	22	22
Other	28	27	32	40	41
	113	109	206	374	374
Country risk allowance	57	56	154	190	190
Loans and securities, net of allowances	56	53	52	184	184
Allowances as a % of loans and securities	50.4 %	51.4 %	74.8 %	50.8 %	50.8 %
Loans and securities, net, as a % of shareholders' equity	2.1 %	1.9 %	2.1 %	8.0 %	7.9 %

During fiscal 1998, the Bank converted the loan granted to the Ivory Coast into discount bonds for an amount of $13 million under the Brady Plan. Particulars, by country, of private-risk and sovereign-risk loans classified as restructured for previous years are as follows: 1997: Peru $12 million; 1996: Panama $6 million; 1994: Brazil $81 million; Poland $82 million and Argentina $45 million.

TABLE 3.15
Impaired Loans
as at October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Private impaired loans, net					
DOMESTIC					
Individuals and small businesses (1)	244	241	192	138	119
Commercial	216	190	175	194	212
Corporate	–	7	18	31	56
Real estate	31	38	61	98	182
Other	–	–	5	5	14
	491	476	451	466	583
INTERNATIONAL					
Commercial – United States	36	–	3	3	11
Real estate – United States	11	8	39	70	83
Real estate – Other	–	–	–	50	52
Other	7	8	5	13	8
	54	16	47	136	154
General allowance for credit risk (3)	(500)	(200)	(100)	(100)	(56)
Total private impaired loans, net	45	292	398	502	681
Impaired loans to designated countries					
Gross	42	57	77	94	92
Allowance	40	52	69	85	85
	2	5	8	9	7
Total impaired loans, net (2)	47	297	406	511	688
Private impaired loans, gross	1,037	1,075	995	1,104	1,310
Allowance for credit losses	992	783	597	602	629
Private impaired loans, net	45	292	398	502	681
Provisioning rate	95.7 %	72.8 %	60.0 %	54.5 %	48.0 %
As a percentage of net loans and bankers' acceptances					
Domestic – Private	1.2 %	1.1 %	1.3 %	1.5 %	2.0 %
International – Private	0.8 %	0.3 %	1.0 %	2.9 %	3.3 %
International – Designated countries	– %	0.1 %	0.2 %	0.2 %	0.2 %
Total	0.1 %	0.6 %	1.0 %	1.5 %	2.1 %
As a percentage of common shareholders' equity	2.0 %	12.5 %	19.1 %	26.4 %	38.5 %

(1) Including $56 million in net consumer loans in 1998 (1997: $42 million; 1996: $37 million; 1995: $39 million; 1994: $28 million).

(2) The Bank has no loans classified as other past-due loans (90 days and over) except for those already designated as impaired.

(3) See page 24 for discussion on the general allowance for credit risk.

Net interest earned on impaired loans went from a positive amount of $15 million in 1997 to a negative amount of $9 million (Table 3.16 opposite), owing to past-due interest bonds received the previous year from designated countries. Aggregate net interest earned on all impaired loans went from 3.3% to -2.6% for the same reason.

Interest Rate Risk Management

Analyzing interest rate sensitivity gaps is one of the methods used to control interest rate risk. Table 3.17 presents a breakdown of assets and liabilities by maturity and illustrates the sensitivity of the Bank's balance sheet to interest rate fluctuations as at October 31, 1998.

In this table, items in Canadian dollars are distinguished from those in foreign currencies, and the trading account and the investment account are shown separately. The investment account is made up of the Bank's main assets and liabilities, notably loans and deposits, whereas the trading account includes the financial instruments linked to the Bank's financial market operations (market making, positioning and trading).

The net sensitivity gap for maturities of one year and under in the Canadian dollar investment account went from a liability-sensitive position of $781 million (or 1.8% of assets) as at October 31, 1997 to an asset-sensitive position of $248 million (or 0.6% of assets) as at October 31, 1998. The asset-sensitive position of net gaps for maturities of over one year increased from $1,994 million at year end 1997 to $2,933 million at year end 1998.

The use of derivatives greatly contributed to extending the average maturity of the Bank's net assets, thereby positioning the Bank for a decline in short-term interest rates. In fact, by using derivatives, the Bank increased the liability-sensitive position of net gaps for maturities of under one year by $3,834 million.

TABLE 3.17A

Interest Rate Sensitivity Analysis – Canadian Dollar Items

as at October 31
(millions of dollars)

	Total	Variable rate	3 months and under	Yield	3 to 6 months	Yield
Assets						
Trading account						
Cash resources	29	6	–	–	–	–
Securities	9,426	–	1,736	5.26	1,946	4.81
Loans	4,567	598	2,775	5.34	48	5.15
Other assets	–	(146)	156	–	–	–
	14,022	458	4,667	5.13	1,994	4.82
Investment account						
Cash resources	1,870	505	1,207	5.44	15	5.53
Securities	3,011	–	1,133	5.55	15	7.97
Loans	34,822	13,863	3,863	6.52	2,036	7.13
Other assets	4,199	2,916	684	5.24	321	5.09
	43,902	17,284	6,887	6.04	2,387	6.85
Total	57,924	17,742	11,554	5.68	4,381	5.93
Liabilities						
Trading account						
Deposits	1,228	891	–	–	–	–
Other liabilities	12,794	2,946	6,455	5.40	541	5.07
	14,022	3,837	6,455	5.40	541	5.07
Investment account						
Deposits	32,784	6,856	6,914	5.12	3,492	5.16
Subordinated debt	312	–	–	–	–	–
Other liabilities	3,987	1,763	752	5.03	317	5.08
Shareholders' equity	2,695	–	–	–	–	–
	39,778	8,619	7,666	5.11	3,809	5.15
Total	53,800	12,456	14,121	5.24	4,350	5.14
Trading gap	–	(3,379)	(1,788)		1,453	
Investment gap	4,124	8,665	(779)		(1,422)	
On-balance sheet gap	4,124	5,286	(2,567)		31	
Derivatives						
Trading derivatives	355	–	271		602	
Investment derivatives	(4,322)	–	(4,749)		281	
Total	(3,967)	–	(4,478)		883	
Total trading gap	355	(3,379)	(1,517)		2,055	
Total investment gap	(198)	8,665	(5,528)		(1,141)	
Total gap, net	157	5,286	(7,045)		914	

TABLE 3.16

Interest on Impaired Loans

for the year ended October 31
(millions of dollars)

	1998	1997	1996	1995	1994
Interest on impaired loans					
Domestic	(9)	(19)	(20)	(18)	(16)
International	–	34	15	31	18
	(9)	15	(5)	13	2
Average impaired loans					
Domestic	276	400	354	427	554
International	76	50	96	149	309
	352	450	450	576	863
Interest as a % of average impaired loans					
Domestic	(3.3)%	(4.8)%	(5.7)%	(4.2)%	(2.9)%
International	–	68.0 %	15.6 %	20.8 %	5.8 %
Total	(2.6)%	3.3 %	(1.1)%	2.3 %	0.2 %

6 to 12 months	Yield	Total 1 year and under	1 to 5 years	Yield	Over 5 years	Yield	Non-interest sensitive
–	–	6	–	–	–	–	23
2,528	4.84	6,210	1,606	4.80	1,367	5.53	243
433	5.19	3,854	201	7.51	–	–	512
–	–	10	–	–	–	–	(10)
2,961	4.89	10,080	1,807	5.10	1,367	5.53	768
–	–	1,727	–	–	–	–	143
142	6.15	1,290	1,018	6.51	492	6.31	211
3,382	6.95	23,144	11,408	7.04	(115)	2.08	385
278	5.19	4,199	–	–	–	–	–
3,802	6.79	30,360	12,426	7.00	377	7.60	739
6,763	5.96	40,440	14,233	6.76	1,744	5.98	1,507
–	–	891	–	–	–	–	337
475	5.14	10,417	1,175	4.75	1,462	5.68	(260)
475	5.14	11,308	1,175	4.75	1,462	5.68	77
6,071	5.76	23,333	8,610	6.03	143	6.36	698
–	–	–	37	11.58	275	7.50	–
113	5.39	2,945	–	–	–	–	1,042
–	–	–	192	9.58	125	9.16	2,378
6,184	5.75	26,278	8,839	6.08	543	7.58	4,118
6,659	5.71	37,586	10,014	5.93	2,005	6.20	4,195
2,486		(1,228)	632		(95)		691
(2,382)		4,082	3,587		(166)		(3,379)
104		2,854	4,219		(261)		(2,688)
(314)		559	(447)		148		95
634		(3,834)	(753)		265		–
320		(3,275)	(1,200)		413		95
2,172		(669)	185		53		786
(1,748)		248	2,834		99		(3,379)
424		(421)	3,019		152		(2,593)

Information on sensitivity gaps for the foreign currency investment account shows that mismatches were limited and that the vast majority of assets and liabilities had maturities of under one year.

Another risk assessment method used by the Bank is to measure the impact of interest rate movements on net interest income and on the present value of shareholders' equity. The Bank structured the investment sensitivity gaps for maturities of one year and under in such a way as to minimize the impact of interest rate fluctuations on the interest spread. Based on the matching position of the Bank's domestic balance sheet as at October 31, 1998, simulations demonstrate that an immediate and sustained 1% rise in interest rates would reduce net interest income by approximately $11 million (before taxes) over 12 months and reduce the present value of shareholders' equity by $56 million (before taxes).

To complement the traditional tools used for measuring financial risk, the Bank applies a VAR methodology to trading activities. According to simulations, if potential losses over a 10-day horizon with a probability of less than 1% are excluded, the VAR of trading activities as at October 31, 1998 resulting from movements in interest rates was $4.3 million, movements in foreign exchange rates $6.1 million, movements in equity and commodity prices $3.9 million and changes in volatilities $1.5 million. The VAR of these types of risk combined amounted to $10.7 million. These amounts are considerably lower than the notional amount of the derivatives used for trading purposes.

Analysis of Off-Balance Sheet Risk Exposure

Risks are also linked to off-balance sheet activities, which consist of commitments to extend credit and derivatives. These financial instruments are usually components of portfolios which include balance sheet items and, as such, are subject to the full range of control measures described earlier. In addition, commitments to extend credit must also comply with the same credit policies as loan operations recorded on the balance sheet. Additional control measures are also applied to derivatives.

TABLE 3.17B

Interest Rate Sensitivity Analysis – Foreign Currency Items

as at October 31
(millions of Canadian dollars)

	Total	Variable rate	3 months and under	Yield	3 to 6 months	Yield
Assets						
Trading account						
Cash resources	9	9	–	–	–	–
Securities	749	–	25	5.23	1	5.06
Loans	1,128	74	848	4.07	–	–
Other assets	–	–	–	–	–	–
	1,886	83	873	4.10	1	5.06
Investment account						
Cash resources	2,944	594	2,139	5.49	197	5.67
Securities	1,386	–	909	6.02	71	5.33
Loans	5,867	1,975	3,323	5.70	349	5.51
Other assets	656	(5,654)	5,909	5.66	187	6.18
	10,853	(3,085)	12,280	5.67	804	5.69
Total	12,739	(3,002)	13,153	5.56	805	5.69
Liabilities						
Trading account						
Deposits	214	167	–	–	–	–
Other liabilities	1,672	461	536	4.39	–	–
	1,886	628	536	4.39	–	–
Investment account						
Deposits	13,800	1,016	7,134	5.61	2,396	5.43
Subordinated debt	654	–	–	–	189	5.05
Other liabilities	523	(6,240)	5,927	5.65	159	5.80
Shareholders' equity	–	–	–	–	–	–
	14,977	(5,224)	13,061	5.63	2,744	5.43
Total	16,863	(4,596)	13,597	5.58	2,744	5.43
Trading gap	–	(545)	337		1	
Investment gap	(4,124)	2,139	(781)		(1,940)	
On-balance sheet gap	(4,124)	1,594	(444)		(1,939)	
Derivatives						
Trading derivatives	(277)	–	(669)		(1,860)	
Investment derivatives	4,463	–	(3,503)		2,893	
Total	4,186	–	(4,172)		1,033	
Total trading gap	(277)	(545)	(332)		(1,859)	
Total investment gap	339	2,139	(4,284)		953	
Total gap, net	62	1,594	(4,616)		(906)	

This section provides more information on the nature of off-balance sheet activities, the risks they involve, and the assessments and control measures applicable to such risks.

Table 3.10 (page 31) provides a breakdown of the risk-weighted credit equivalent amount of the various off-balance sheet items included in the calculation of total risk-weighted assets. They represent a relatively low proportion in comparison to the other credit risks recorded on the balance sheet. Off-balance sheet items accounted for 12.4% of risk-weighted assets, compared to 10.0% in 1997.

Note 18 to the financial statements (page 64) presents the maturity profile of the derivatives held by the Bank as at September 30, 1998. It should be noted that most of these instruments have short maturities: 66.6% of interest rate contracts and 69.5% of foreign exchange contracts mature within six months.

Note 18 further presents the notional (or nominal) amounts of derivatives used by the Bank for trading and asset/liability management (other activities). Table 3.17 shows how, for asset/liability management purposes, derivatives modify interest rate sensitivity gaps.

The notional amount of derivatives in the trading account is not necessarily representative of their risk level but rather reflects the high number of transactions.

Note 19 to the financial statements (pages 66 and 67), which provides data on the credit equivalent amount of derivatives, confirms the analysis of Table 3.10 (page 31) with respect to the low proportion of derivatives on the balance sheet.

6 to 12 months	Yield	Total 1 year and under	1 to 5 years	Yield	Over 5 years	Yield	Non-interest sensitive
–	–	9	–	–	–	–	–
9	6.48	35	154	7.68	476	5.81	84
–	–	922	–	–	–	–	206
–	–	–	–	–	–	–	–
9	6.48	966	154	7.68	476	5.81	290
–	–	2,930	–	–	–	–	14
5	6.50	985	83	5.85	208	6.54	110
157	6.38	5,804	79	6.07	8	5.51	(24)
214	4.79	656	–	–	–	–	–
376	5.48	10,375	162	5.96	216	6.50	100
385	5.50	11,341	316	6.80	692	6.03	390
–	–	167	–	–	–	–	47
–	–	997	398	5.45	342	5.70	(65)
–	–	1,164	398	5.45	342	5.70	(18)
3,248	5.01	13,794	6	6.32	–	–	–
80	6.97	269	–	–	385	8.13	–
214	4.79	60	–	–	463	8.35	–
–	–	–	–	–	–	–	–
3,542	5.04	14,123	6	6.32	848	8.25	–
3,542	5.04	15,287	404	5.46	1,190	7.52	(18)
9		(198)	(244)		134		308
(3,166)		(3,748)	156		(632)		100
(3,157)		(3,946)	(88)		(498)		408
1,128		(1,401)	913		(28)		239
4,680		4,070	30		363		–
5,808		2,669	943		335		239
1,137		(1,599)	669		106		547
1,514		322	186		(269)		100
2,651		(1,277)	855		(163)		647

The Bank limits credit risk exposure related to derivatives in various ways. For instance, in dealings with certain counterparties, it reduces its exposure by means of netting or mark-to-market agreements. In addition, credit risk exposure is reduced substantially when the relevant instruments are listed on a stock exchange. As shown in Note 18 to the financial statements (page 65), most of the credit equivalent amount for derivatives is contracted with reliable counterparties, particularly major banks and OECD-member countries.

CONCLUSION

For the Bank, fiscal 1998 was a year of growth, profitability and prudence.

Because of its prudent portfolio mix, the Bank was not greatly affected by the turbulence that shook financial markets. Moreover, it took measures to further strengthen its financial base, notably by moving swiftly to increase its general allowance for credit risk.

The market recognized the present and future profitability of the National Bank by giving its shareholders a total return of 18.2% over the course of fiscal 1998. During this same period, Canadian banks and trust companies on average yielded a negative return overall.

Management is confident that the Bank's current strategy will lead to an even stronger and more profitable institution, for the benefit of shareholders and clients alike.

DERIVATIVE FINANCIAL INSTRUMENTS AND RISK

The derivative financial instruments used by the Bank (forwards, futures, swaps and options) are contracts whose value is derived mainly from interest rates and foreign exchange rates and, to a lesser extent, commodity prices and equity prices.

Business Objectives

Derivatives are the strategic tool of choice for risk management. Accordingly, the Bank uses them for trading activities and asset/liability management.

The Bank uses its trading portfolio to carry out market-making or trading operations and to position itself on markets. The Bank also makes its expertise in risk management available to its commercial and institutional clients by offering management solutions for risk exposure.

Derivatives are one of the balance sheet tools available for managing interest rate and foreign exchange risk exposure as well as asset and liability matching. It is essential that these risks, which are a normal part of banking, be managed in order to protect the interest spread and the present value of capital.

For trading activities, transactions are accounted for on a mark-to-market basis. For asset/liability management operations, the derivatives are accounted for on an accrual basis in order to match the accounting treatment of the assets and liabilities being hedged.

Risk

The risks inherent in derivatives are similar to the general risks for financial instruments. They include most notably market risk, credit risk, liquidity risk and legal risk.

Market risk is defined as the potential for a deterioration in the value of a derivative instrument because of fluctuations in the underlying primary instrument (interest rates or foreign exchange rates). All derivative risks are accurately measured, reevaluated on a daily basis and managed in accordance with the policies approved by the Bank's Board of Directors.

Credit risk, also known as the credit equivalent amount, is the value of the loss incurred in the event a counterparty fails to honour its commitments. It is measured by taking into account the current replacement cost of the contract (if it is positive), future credit risk exposure (which is the estimated change in the value of the contract to maturity) and the impact of master netting agreements.

Liquidity risk consists of two elements: market liquidity and cash flow. In the first instance, risk exposure stems from a possible delay in settling a position when, for example, the market lacks sufficient depth. The Bank controls this risk by taking relatively short positions and by operating on markets where its positions represent only a very small proportion of total volume.

In the second instance, cash flow risk derives from the timing of cash receipts and outflows and is managed as part of the Bank's overall liquidity management process.

Legal risk exists where there is a possibility that a counterparty does not have the necessary legal power to enter into a transaction or the legal documents for such a transaction are deficient. The Bank manages this risk by applying the necessary checks and controls and by working with the national and international organizations that set the standards to be respected.

In addition to being managed as part of the Bank's general risk management policies, derivative risk exposure is also subject to special assessment and control measures. An independent unit within the Bank is responsible for monitoring financial transactions and administering risk control systems. The duties of this unit include ensuring that transactions are settled and recorded, measuring position risk, checking that the policies adopted by the Board of Directors are applied and controlling the quality of analysis systems.

QUARTERLY RESULTS

(millions of dollars, except for per share amounts)

	Net interest income (taxable equivalent basis)[1]	Provision for credit losses	Other income[1]	Non-interest expenses	Net income	Net income per common share		Dividends (thousands of dollars)		Return on common shareholders' equity
						Basic	Fully diluted	Common	Preferred	%
1st Q	265	63	185	296	51	0.27	0.26	15,869	8,063	10.4
2nd Q	267	63	177	294	52	0.27	0.27	15,931	8,933	10.4
3rd Q	281	87	194	292	57	0.29	0.29	16,010	10,679	10.8
4th Q	282	62	163	286	57	0.29	0.28	16,096	10,435	10.6
1994	1,095	275	719	1,168	217	1.12	1.10	63,906	38,110	10.5
1st Q	281	56	167	292	61	0.31	0.31	16,173	10,167	11.1
2nd Q	303	76	171	301	57	0.29	0.28	16,256	9,968	10.5
3rd Q	293	56	185	314	64	0.33	0.33	16,327	9,983	11.4
4th Q	304	67	189	322	63	0.33	0.32	16,393	9,370	11.0
1995	1,181	255	712	1,229	245	1.26	1.24	65,149	39,488	11.0
1st Q	281	44	214	328	75	0.41	0.41	18,926	6,855	14.0
2nd Q	280	44	230	401	71	0.39	0.38	20,667	6,787	13.2
3rd Q	292	104	299	340	98	0.55	0.54	20,769	6,724	17.7
4th Q	289	43	227	344	74	0.41	0.41	20,893	6,675	12.8
1996	1,142	235	970	1,413	318	1.76	1.74	81,255	27,041	14.5
1st Q	325	56	231	355	84	0.46	0.45	20,980	6,563	14.2
2nd Q	310	56	246	361	80	0.44	0.44	25,398	6,537	13.6
3rd Q	322	57	261	375	88	0.47	0.47	25,551	6,538	14.0
4th Q	367	121	318	398	90	0.49	0.48	25,587	6,538	14.1
1997	1,324	290	1,056	1,489	342	1.86	1.84	97,516	26,176	14.0
1st Q	329	50	286	387	100	0.55	0.54	25,658	6,608	15.3
2nd Q	320	49	300	401	95	0.52	0.52	29,079	6,701	14.6
3rd Q	331	46	285	401	98	0.53	0.52	29,142	6,720	14.1
4th Q[3]	330	48	271	400	87	0.47	0.47	29,213	6,495	12.5
1998[3]	1,310	193	1,142	1,589	380	2.07	2.05	113,092	26,524	14.1

	Impaired loans				Number of common shares (in thousands)		Per common share			Number of employees[2]	Number of branches in Canada
	Net private	Designated countries		Net total	Average	End of period	Book value	Stock trading range			
		Gross outstanding	Allowance					High	Low		
1st Q	812	340	277	875	158,680	158,708	10.55	11.63	10.13	12,081	647
2nd Q	786	251	222	815	159,306	159,339	10.71	11.38	9.00	10,870	646
3rd Q	733	257	226	764	160,093	160,126	10.89	9.25	8.25	10,882	645
4th Q	681	92	85	688	160,947	160,976	11.09	10.00	8.63	10,746	641
1994											
1st Q	620	96	88	628	161,714	161,740	11.30	10.00	8.63	10,774	643
2nd Q	556	96	86	566	162,545	162,573	11.51	10.25	9.00	10,576	644
3rd Q	530	96	87	539	163,259	163,279	11.74	11.50	10.13	10,796	641
4th Q	502	94	85	511	163,940	163,963	11.88	11.88	10.38	10,620	629
1995											
1st Q	399	94	86	407	164,575	164,594	11.86	11.38	10.38	11,514	648
2nd Q	395	93	84	404	165,330	165,348	12.13	12.00	11.00	11,295	649
3rd Q	392	81	72	401	166,161	166,182	12.53	12.00	11.05	11,568	632
4th Q	398	77	69	406	167,119	167,151	12.70	13.90	11.15	11,402	632
1996											
1st Q	387	75	68	394	168,046	168,315	13.04	14.40	13.20	11,668	665
2nd Q	394	55	50	399	169,163	169,369	13.36	16.80	13.75	11,584	659
3rd Q	392	54	49	397	170,121	170,250	13.68	18.25	15.65	11,736	643
4th Q	292	57	52	297	170,391	170,461	13.99	20.30	17.00	11,651	637
1997											
1st Q	289	57	53	293	170,762	170,986	14.47	24.60	20.35	11,837	640
2nd Q	289	36	35	290	171,126	171,210	14.79	31.25	22.80	11,815	642
3rd Q	290	39	37	292	171,401	171,518	15.19	30.85	27.10	12,149	643
4th Q[4]	45	42	40	47	171,600	171,616	13.86	26.70	20.10	12,041	646
1998											

(1) As of 1996, realized and unrealized gains or losses are recorded under other income.

(2) On a full-time equivalent basis and excluding the subsidiary Lévesque Beaubien Geoffrion.

(3) Excluding the write-off of $64 million or 38¢ per share of goodwill.

(4) See page 24 for discussion on the general allowance for credit risk.

GLOSSARY OF FINANCIAL TERMS

Allowance for credit losses
Allowance taken to absorb anticipated credit-related losses (loans, acceptances, guarantees, letters of credit, deposits by other banks and derivatives), namely, the sum of annual provisions less write-offs, net of recoveries. The allowance for credit losses includes country risk allowances, specific provisions and the general allowance for credit risk.

Asset-based lending
Loans or other forms of credit secured by assets belonging to the borrower (e.g. accounts receivable or inventory items) which are strictly controlled by the lender until settlement of the debt.

Assets under administration
Assets in respect of which a financial institution provides administrative services such as custodial services, collection of investment income, settlement of purchase and sale transactions and record-keeping. Assets under administration, which are beneficially owned by clients, are not reported on the balance sheet of the institution offering such services.

Assets under management
Assets managed by a financial institution which are beneficially owned by clients. Management services are more comprehensive than administrative services, and include selecting investments or offering investment advice. Assets under management, which may also be administered by the financial institution, are not reported on its balance sheet.

Average assets
Daily average of balance sheet assets.

Bankers' acceptance
Short-term debt security traded on the money market which a bank guarantees on behalf of a borrower and for which the borrower pays a stamping fee.

Capital
Amount which would be owed to the holders of shares and bank debentures if assets had to be liquidated to reimburse depositors and other creditors. Capital consists of bank debentures, shareholders' equity and non-controlling interest.

Capital ratios
Ratios of capital, as defined by regulatory authorities, to risk-weighted assets. The Bank for International Settlements distinguishes two types of capital: Tier 1 capital, or base capital, consists of common shareholders' equity, non-cumulative preferred shares and non-controlling interest in subsidiaries less goodwill. Tier 2, or supplementary capital, consists of other preferred shares and subordinated debentures at their book value and the eligible portion of the general allowance for credit risk less investments in associated companies. Total regulatory capital, or total capital, is the sum of Tier 1 and Tier 2 capital.

Derivatives
Financial futures or options whose value is "derived" from interest rates, foreign exchange rates or equity prices. Derivatives are used in treasury operations as well as for hedging regular financial instruments. The most common types of derivatives include foreign currency or interest rate futures, swaps and options.

Earning assets
Total assets which generate interest for the Bank. Earning assets are calculated as total assets less cash and other non-interest bearing assets.

Foreign currency and interest rate swaps
Transactions in which counterparties agree to exchange, for a specified period, currencies and/or streams of interest payments (generally by exchanging a fixed rate for a floating one) based on an amount of notional principal.

Foreign currency future
Contractual obligation to buy or sell, on or before a specified future date, a given quantity of foreign currency at a given exchange rate.

Foreign currency or interest rate option
The right, but not the obligation, to buy (call option) or sell (put option) at or by a set date, a given amount of foreign currency or securities at a set price (strike price).

Forward rate agreement
Contractual obligation to buy or sell, on or before a specified future date, a given quantity of a financial instrument at a given interest rate.

Guarantees and letters of credit
Irrevocable assurances that a bank will make payments for a client which cannot meet its financial obligations to third parties.

Impaired loan
A loan is considered impaired when, in the opinion of management, there is reasonable doubt as to the payment of principal or interest. Any loan where payments are 90 days past due falls into this category, unless there is no doubt as to the collectibility of principal and interest.

Liquid assets
Assets held as cash or securities easily convertible to cash, such as deposits with other banks and securities.

Matching
The process of equating asset and liability maturities so as to minimize interest rate risk.

Net income per share
Net income available to holders of common shares, namely, net income less dividends on preferred shares, divided by the average number of common shares outstanding during the fiscal year.

Net interest income
Difference between the interest earned on assets and the interest paid on liabilities. When expressed as a percentage of average assets, it is called net interest margin or interest spread.

Notional principal
Contract amount used as a reference point to calculate payments for off-balance sheet instruments such as forward rate agreements and interest rate swaps. It is considered "notional" as the principal amount itself never changes hands.

Point
Unit of measure equal to one percentage (1%).

Provision for credit losses
Amount added to the allowance for credit losses to bring it to a level that management considers adequate, taking into account write-offs and recoveries with respect to specific loans.

Return on common shareholders' equity
Amount available to holders of common shares, namely, net income less dividends on preferred shares, expressed as a percentage of the average value of the sum of retained earnings and common shares on the balance sheet.

Risk weighting
Risk-weighting factors are applied to the face value of certain assets in order to present comparable risk levels. This procedure is also used to recognize the risk in off-balance sheet instruments by adjusting the notional value to balance sheet (or credit) equivalents and then applying the appropriate risk-weighting factors. Total risk-weighted assets are used in calculating the various capital ratios according to the rules of the Bank for International Settlements.

Securitization
Transaction in which certain assets, such as mortgages, are sold to an entity which finances their acquisition by issuing negotiable securities.

Shareholders' equity
The sum of the capital stock paid in by shareholders and retained earnings. Shareholders' equity is the amount that would be owed to shareholders if assets had to be liquidated to reimburse depositors and other creditors.

Subordinated debenture
Unsecured debt instrument issued by a bank and for which repayment, in the event of liquidation, ranks behind the claims of depositors and certain other creditors. Convertible subordinated debentures can be exchanged for shares at the option of the holder, the issuer or both.

Taxable equivalent basis
Calculation method used to gross up certain tax-exempt income (primarily dividends) by the income tax that would have been payable had it been taxable. The gross-up of such income permits a uniform comparison of the yield on the various types of assets, such as those comprising net interest income, regardless of their tax treatment.

Trading account
Liquid assets used for trading on financial markets. This account is recorded on the balance sheet at its market value.

FINANCIAL STATEMENTS 1998

YEAR ENDED OCTOBER 31

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MANAGEMENT'S REPORT

The consolidated financial statements and all information contained in this document were prepared by the management of the Bank, which is responsible for their accuracy, objectivity and completeness. These consolidated financial statements were prepared in accordance with generally accepted accounting principles, including the accounting requirements of the Superintendent of Financial Institutions Canada.

Management maintains the necessary accounting and internal control systems designed to ensure that reliable financial information is produced and that assets are safeguarded, to a reasonable extent, against any loss or unauthorized use. The procedures used include following up relevant criteria for hiring and training personnel, establishing an organizational structure to ensure appropriate distribution of tasks, regularly updating policies, procedures and permanent instructions and appropriate budget control by centre of responsibility. These systems are regularly evaluated by a group of internal auditors, whose findings are presented from time to time to the Audit Committee of the Board of Directors of the Bank (the "Audit Committee"). The Board of Directors, through the Audit Committee composed entirely of directors who are neither officers nor employees of the Bank, is responsible for examining and overseeing the Bank's practices with respect to accounting and to the disclosure of financial information.

The Superintendent of Financial Institutions Canada each year makes such examination of the Bank's affairs as he deems necessary to satisfy himself that the provisions of the Bank Act having reference to the protection of the depositors and shareholders of the Bank are duly observed, and that the Bank is in a sound financial condition. He meets with the Audit Committee, with or without management being present.

The independent auditors, whose report follows, have audited the consolidated financial statements of the Bank. They meet with the Audit Committee from time to time, with or without management being present, to discuss their audit and questions related thereto.

Léon Courville
President, Personal and Commercial Bank, and Chief Operating Officer

Montreal, November 26, 1998

AUDITORS' REPORT

To the Shareholders of National Bank of Canada

We have audited the Consolidated Balance Sheet of National Bank of Canada as at October 31, 1998 and the Consolidated Statements of Income, Changes in Shareholders' Equity and Changes in Financial Position for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Bank as at October 31, 1998 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles, other than the accounting for the general allowance for credit risk which is in accordance with the accounting requirements of the Superintendent of Financial Institutions Canada under the Bank Act, as described in Note 1.

The consolidated financial statements for the year ended October 31, 1997 were audited by Price Waterhouse and Samson Bélair/Deloitte & Touche who expressed an opinion thereon without reservation in their report dated November 24, 1997.

Samson Bélair/Deloitte & Touche
General Partnership
Chartered Accountants

Mallette Maheu
General Partnership
Chartered Accountants

Montreal, November 26, 1998

CONSOLIDATED STATEMENT OF INCOME

Year ended October 31
(millions of dollars except for per share amounts)

	Note	1998	1997
Interest income and dividends			
Loans		$ 2,792	$ 2,622
Securities		332	320
Deposits with regulated financial institutions		250	163
		3,374	3,105
Interest expense			
Deposits		1,885	1,608
Bank debentures		76	84
Other		106	94
		2,067	1,786
Net interest income		1,307	1,319
Other income			
Capital market fees		313	313
Deposit and payment service charges		144	132
Realized and unrealized gains on securities, net amount		94	153
Card service revenues		123	95
Lending fees		146	115
Bankers' acceptances, letters of credit and guarantee		44	41
Foreign exchange revenues		46	39
Trust services		31	28
Other		201	140
		1,142	1,056
Gross revenues		2,449	2,375
Provision for credit losses		193	290
		2,256	2,085
Non-interest expenses			
Salaries and staff benefits		822	781
Premises		164	161
Computers and equipment		210	185
Communications		60	57
Write-off of goodwill	13	64	–
Other		333	305
		1,653	1,489
Income before income taxes		603	596
Income taxes	14	256	238
Income before non-controlling interest		347	358
Non-controlling interest		31	16
Net income		$ 316	$ 342
Net income per common share	15		
– Basic		$ 1.69	$ 1.86
– Fully diluted		$ 1.67	$ 1.84

CONSOLIDATED BALANCE SHEET

as at October 31
(millions of dollars)

	Note	1998	1997
ASSETS			
Cash resources			
Cash and deposits with Bank of Canada		$ 530	$ 304
Deposits with regulated financial institutions		4,322	4,172
		4,852	4,476
Securities	3		
Investment account securities		4,397	3,997
Trading account securities		10,175	6,013
		14,572	10,010
Loans	4		
Residential mortgages		14,290	13,012
Personal and credit cards		5,976	5,948
Business and government		21,171	19,144
Securities purchased under resale agreements		4,947	9,155
		46,384	47,259
Other			
Customers' liability under bankers' acceptances		2,658	2,273
Premises and equipment	6	344	347
Other assets	7	1,853	1,870
		4,855	4,490
		$ 70,663	$ 66,235
LIABILITIES			
Deposits	8		
Personal		$ 20,213	$ 20,724
Business and government		18,462	13,587
Deposit-taking institutions		9,351	8,959
		48,026	43,270
Other			
Bankers' acceptances		2,658	2,273
Obligations related to securities sold short		4,831	4,225
Securities sold under repurchase agreements		8,315	9,038
Other liabilities	9	3,172	3,600
		18,976	19,136
Subordinated debt			
Bank debentures	10	966	1,069
Shareholders' equity			
Capital stock	11		
Preferred		317	376
Common		1,327	1,309
Retained earnings		1,051	1,075
		2,695	2,760
		$ 70,663	$ 66,235

André Bérard
Chairman of the Board and Chief Executive Officer

Léon Courville
President, Personal and Commercial Bank, and Chief Operating Officer

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Year ended October 31

(millions of dollars)

	Note	1998	1997
Capital stock, at beginning of year		$ 1,685	$ 1,644
Issue of common shares		18	41
Redemption of Preferred Shares, Series 5, 7 and 8		(59)	–
Capital stock, at end of year		$ 1,644	$ 1,685
Retained earnings, at beginning of year		$ 1,075	$ 855
Net income		316	342
Dividends			
Preferred shares		(27)	(26)
Common shares		(113)	(98)
Income taxes related to dividends on Preferred Shares, Series 10, 11 and 12		(1)	(1)
Expenses related to share issues, net of income taxes		(2)	(8)
Unrealized foreign currency translation gains (losses), including income tax recoveries of $27 (1997: $10)		(14)	11
Adjustment to general allowance for credit risk, net of income taxes of $117	5	(183)	–
Retained earnings, at end of year		$ 1,051	$ 1,075

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year ended October 31
(millions of dollars)

	1998	1997
Operating activities		
Net income	$ 316	$ 342
Items not affecting cash resources:		
Provision for credit losses	193	290
Amortization	61	60
Deferred income taxes	35	(18)
Write-off of goodwill	64	–
Pension expense	7	2
	676	676
Current income taxes	(91)	106
Accrued interest	3	(71)
Other	(275)	862
	313	1,573
Financing activities		
Deposits	4,756	3,145
Obligations related to securities sold short	606	167
Securities sold under repurchase agreements	(723)	6,665
Bank debentures:		
Issue	–	150
Redemption	(163)	(121)
Adjustment for foreign currency translation	60	24
Common shares:		
Issue	18	41
Preferred shares:		
Redemption	(59)	–
Dividends	(140)	(124)
Other	(64)	691
	4,291	10,638
Investing activities		
Securities	(4,562)	(1,596)
Loans	382	(9,614)
Premises and equipment	(48)	(53)
	(4,228)	(11,263)
Increase in cash resources	376	948
Cash resources, at beginning of year	4,476	3,528
Cash resources, at end of year	$ 4,852	$ 4,476

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

October 31, 1998
(Figures in tables are in millions of dollars, unless otherwise indicated)

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements were prepared in accordance with section 308(4) of the Bank Act, which states that Canadian generally accepted accounting principles are to be applied unless otherwise specified by the Superintendent of Financial Institutions Canada (the "Superintendent"). These principles differ in some regards from United States generally accepted accounting principles, as explained in Note 26.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of income and expenses during the period covered by the financial statements. Actual results could differ from those estimates.

The significant accounting policies used in preparing these consolidated financial statements, including the accounting requirements of the Superintendent, are summarized below. The Superintendent has specified an accounting requirement for the general allowance for credit risk which does not conform to generally accepted accounting principles. The accounting policies for all other financial statement items conform, in all material respects, to generally accepted accounting principles.

Consolidation

The consolidated financial statements of the Bank include the assets, liabilities and operating results of the Bank and all its subsidiaries. The purchase method is used to account for the acquisition of subsidiaries. Goodwill is amortized using the straight-line method over a period corresponding to its estimated useful life, not exceeding 20 years. Goodwill is written down to fair value when the decline in value is considered to be permanent based on projected investment yield which takes into account the related risks.

Translation of foreign currencies

Items in foreign currencies included in the Consolidated Balance Sheet are translated into Canadian dollars at the exchange rates prevailing at year end. Income and expenses are translated at the average exchange rates prevailing during the year.

Spot and forward foreign exchange positions are kept in balance insofar as practicable. Any gain or loss on these positions is recognized in the Consolidated Statement of Income, with the exception of positions related to net foreign-currency investments in offices abroad.

Gains and losses on net foreign-currency investments in branches and subsidiaries abroad are recorded under retained earnings, less the after-tax gains and losses applicable to instruments used for hedging purposes. These gains or losses are not charged to income until they are realized.

Securities

Securities are divided into two major categories: investment account securities and trading account securities.

Investment account securities are purchased with the intention of holding them to maturity. Equity securities are stated at their acquisition cost if the Bank does not have a significant influence, while debt securities are stated at their unamortized acquisition cost. Premiums and discounts on debt securities are amortized using the yield method over the period to maturity of the related securities or, on occasion, until disposal of the security. Gains or losses realized on the disposal of securities and the amortization of premiums and discounts are recorded under income for the year. Any permanent impairment in the value of securities held for investment is charged to the year's income.

Trading account securities are purchased for resale in the short term. They are presented at their fair value based on publicly disclosed market prices. In the event market prices are not available, the fair value is estimated on the basis of the market prices of similar securities. Realized and unrealized gains or losses on these securities are recorded in income.

Investment account securities include loan substitute securities. These are customer financings which have been structured as after-tax securities rather than conventional loans in order to provide the issuers with a borrowing rate advantage. These securities are recorded on the same basis as a loan.

The Bank records all income relating to securities on an accrual basis.

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Loans

Loans are stated net of the allowance for credit losses and the general allowance for credit risk.

A loan is considered impaired when, in the opinion of management, there is reasonable doubt as to the ultimate collectibility of a portion of principal or interest or where payment of interest is contractually past due 90 days, unless there is no doubt as to the collectibility of principal and interest. A loan may revert to performing status only when principal and interest payments have become fully current.

When loans are deemed impaired, interest income ceases to be recorded and the book value of the loans is adjusted to its estimated realizable amount by writing off all or part of the loan and/or by taking a provision for credit losses.

Foreclosed assets held for sale in settlement of an impaired loan are recorded at the time of foreclosure at the lower of the recorded balance of the foreclosed loan or the estimated net proceeds from the sale of the assets. Any difference between the carrying amount of the loan and the estimated realizable amount of the assets is posted to the provision for credit losses. The loan is then adjusted to take into account the revenues received or the costs incurred after foreclosure.

The provision for credit losses, posted directly to income for the year, consists of the net change in the allowance for credit losses and write-offs of the carrying amounts resulting from foreclosed assets, less recoveries.

Fees and commissions related to the granting of loans and commitments to extend credit are amortized over the term thereof and recorded in the Consolidated Statement of Income.

Loans also include securities sold under repurchase agreements which the Bank has purchased and simultaneously committed to resell to the initial buyer at a specified price on a specified date. Since ownership of the securities does not change, the transaction is treated as a loan by the Bank. The securities are recorded at cost and the related interest income is recorded on an accrual basis.

Allowance for credit losses

The specific allowance related to loans considered impaired is established for all such loans for which the impairment could be estimated individually, reducing them to their estimated realizable amounts. For groups of loans consisting of large numbers of homogeneous balances of relatively small dollar amounts, the extent of impairment is estimated for each group of loans by applying formulas that take into account past loss experience, economic conditions and other relevant circumstances. The estimated realizable amounts are measured by discounting expected future cash flows.

The allowance for credit losses in relation to loans to countries designated by the Superintendent is constantly reevaluated on the basis of exposure in the various countries and the underlying economic conditions.

General allowance for credit risk (see Note 25)

On October 22, 1998, the Superintendent provided guidance on establishing a general allowance for credit risk. The criteria for the general allowance for credit risk should include losses which management estimates to have occurred in the portfolio at the balance sheet date relating to individual loans or groups of loans not yet specifically identified as impaired. The general allowance for credit risk is not a substitute for the specific allowances that are set aside for impaired loans.

The general allowance for credit risk was established by taking into consideration historical trends in the loss experience during an economic cycle, the current portfolio profile and estimated credit losses for the current phase of the economic cycle. In compliance with the guidance provided by the Superintendent, any significant adjustment to the general allowance for credit risk, net of income taxes, is treated as a one-time charge to retained earnings, with no adjustment to opening retained earnings.

Mortgage-backed securities

The Bank finances a portion of its mortgage loan portfolio through the mortgage-backed securities program provided for in the National Housing Act. Under this program, the Bank pools eligible mortgage loans and sells ownership rights in these pools to investors. Investors are paid a coupon rate set in advance and the principal from the underlying mortgages. The Canada Mortgage and Housing Corporation (CMHC) unconditionally guarantees the payments to the investors. The Bank continues to service the mortgage loans thus securitized.

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Mortgage-backed securities (cont.)

The Bank is committed to the CMHC to make sufficient funds regularly available to the central payor and transfer agent to pay the amounts due to investors, whether or not the mortgagors have made their payments. Moreover, the Bank must place all funds due to investors at maturity of the securities at the disposal of the central payor and transfer agent. Should the Bank default, the CMHC can assign the servicing of the securitized loans to another servicer.

Issuance costs for mortgage-backed securities include the direct costs incurred in assembling and selling the securities and the discount at sale. These costs are charged in their entirety to the Consolidated Statement of Income at the time of sale by way of a deduction from the proceeds of the sale of securities.

The normal servicing fees which the Bank collects for servicing the securitized mortgage loans are set at 25 basis points. They are credited to other income when collected.

The Bank also collects a net interest spread over the life of the mortgage-backed securities. This spread is the interest collected from mortgagors less the sum of the interest paid to investors and the normal servicing fees.

The estimated present value of the net interest spread, based on the assumption that the annual mortgage prepayment rate is between 0% and 23%, is added to the proceeds from the sale of securities as a receivable and is included in establishing the gains or losses at the date of sale. This receivable is drawn down as mortgage payments are received and the resulting yield is charged to interest income.

Customers' liability under bankers' acceptances

The potential liability of the Bank under bankers' acceptances is recorded as a liability in the Consolidated Balance Sheet. The Bank's potential recourse towards customers is recorded as an equivalent offsetting asset.

Premises and equipment

Premises and equipment are recorded at cost and amortized over their estimated useful lives according to the following methods and rates:

	Methods	Rates
Buildings	(a) or (b)	2% to 10%
Equipment and furniture	(a) or (b)	20% to 33⅓%
Leasehold improvements	(a)	(c)

(a) straight-line
(b) diminishing balance
(c) over the lease term plus the first renewal option

Obligations related to securities sold short

These liabilities represent the Bank's obligation to deliver securities it has sold but which were not owned at the time of sale. Gains and losses on the sale and adjustments to market value are charged to income for the year.

Securities sold under repurchase agreements

These liabilities represent securities which the Bank has sold and simultaneously committed to repurchase from the initial buyer at a specified price on a specified date. Since ownership of the securities does not change, the operation is treated as a loan to the Bank. The securities are recorded at cost and the interest expense is recorded on an accrual basis.

Income taxes

The Bank provides for income taxes under the income tax allocation method. Deferred income taxes result from timing differences in the recognition of various items for financial reporting and for income tax purposes, the main such items being the allowance for credit losses and the general allowance for credit risk. Deferred income taxes represent tax benefits with respect to deductions the Bank may claim to reduce its taxable income in future years.

No provision for deferred income taxes was taken for the portion of retained earnings of foreign subsidiaries which is permanently reinvested.

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Derivative financial instruments

The Bank uses various types of derivatives to enable clients to manage their market risk exposures as well as for its own asset/liability management and trading purposes.

The main derivative instruments used by the Bank are foreign exchange forward contracts, futures, forward rate agreements, foreign currency and/or interest rate swaps and interest rate or foreign currency options.

To be designated as a non-trading derivative contract and receive hedge accounting treatment, the contract must substantially offset the effects of interest rate or foreign exchange rate exposures to the Bank, must be documented at inception as a non-trading derivative contract, and must have a high correlation at inception and throughout the contract period between the derivative contract and the hedged risk.

Derivatives used to enable clients to manage their market risk exposures and to generate income from the Bank's trading activities are marked to market and the resulting gains or losses are recorded in income.

When asset/liability management derivatives are used to manage interest rate and foreign currency exposures, the resulting gains or losses realized are deferred and amortized to income over the life of the hedged assets or liabilities.

Pension plans and other retirement benefits

Pension costs related to current services are charged to the Consolidated Statement of Income in the period during which the services are rendered. Past service costs, experience gains or losses and the funding excess existing on the date the accounting policy came into effect, which have not yet been charged to the Consolidated Statement of Income, are amortized over the expected average remaining service life of the employee group covered by the plans. The difference between the pension expense and the funding payments is recorded in the Consolidated Balance Sheet under "Other assets" or "Other liabilities", as applicable.

The Bank also offers a variety of complementary plans such as health and dental care benefits and life insurance coverage to its employees, eligible retired employees and their dependents. The costs of these benefits are charged to income as they are incurred.

Stock option plan

The Bank provides compensation to certain employees in the form of a stock option plan. The exercise price for each option awarded is equal to the closing price of the common shares of the Bank on the Montreal Exchange or the Toronto Stock Exchange, whichever is higher, on the business day preceding the date of the award. When options are exercised, the proceeds to the Bank are credited to common shares.

2. MORTGAGE-BACKED SECURITIES

	1998	1997
Principal amount of securitized mortgage pools	$ 760	$ 1,063
Average rate of mortgage pools	7.29 %	7.60 %
Average coupon rate paid to investors	5.27 %	5.64 %
Maturity dates of securities	December 1998 to February 2003	December 1997 to July 2002
Present value of net interest spread	$ 26	$ 35

3. SECURITIES

Securities held and effective yields on the investment account were as follows:

	Within 3 months		3 to 6 months		6 to 12 months	
	$	%	$	%	$	%
Investment account						
Securities issued or guaranteed by						
Canada	9	3.0	–	–	61	5.7
Provinces	552	5.5	32	5.4	–	–
Municipalities or school boards	23	5.3	–	–	–	–
Debt securities	1,157	5.9	47	8.7	78	6.6
Equity securities						
Floating-rate preferred shares	16	6.4	–	–	–	–
Fixed-rate preferred shares	–	–	–	–	8	8.0
Other securities	282	5.5	7	5.5	–	–
Loan substitutes	3	–	–	–	–	–
Total of investment account	2,042	5.7	86	7.2	147	6.3
Trading account						
Securities issued or guaranteed by						
Canada	62		1,670		1,942	
Provinces	105		118		48	
Municipalities or school boards	84		7		28	
Debt securities	1,508		152		505	
Equity securities						
Floating-rate preferred shares	2		–		14	
Fixed-rate preferred shares	–		–		–	
Other securities	–		–		–	
Total of trading account	1,761		1,947		2,537	
Total securities	3,803		2,033		2,684	

Where no organized market exists for which prices are publicly disclosed, the fair value is estimated using the market prices of similar securities.

The calculation of the yield rate is based on annual average balances. The yield rate of tax-exempt securities, including in particular most of the dividends received, has not been adjusted on a taxable equivalent basis.

LDC bonds include loans granted to less developed countries and subsequently restructured as bonds under the Brady Plan, net of the country risk allowance. Such bonds are guaranteed by the United States government and have longer maturities and more favourable conditions for the borrowing country.

1 to 5 years		Over 5 years		No specific maturity		1998 Book value		1998 Market value	1997 Book value	1997 Market value
$	%	$	%	$	%	$	%	$	$	$
575	7.6	300	6.8	–	–	945	7.2	979	1,466	1,526
137	6.6	60	9.5	–	–	781	6.0	798	258	272
–	–	–	–	–	–	23	5.3	23	63	67
332	6.0	298	6.5	–	–	1,912	6.1	1,908	1,640	1,643
–	–	–	–	–	–	16	6.4	16	26	26
44	6.4	–	–	12	–	64	5.4	61	63	66
–	–	6	–	284	1.5	579	3.5	559	411	436
13	–	36	–	25	–	77	–	78	70	70
1,101	6.8	700	6.5	321	1.4	4,397	5.9	4,422	3,997	4,106
1,028		486		–		5,188		5,188	2,532	2,532
276		772		–		1,319		1,319	909	909
258		157		–		534		534	464	464
188		406		27		2,786		2,786	1,804	1,804
10		–		3		29		29	–	–
–		–		1		1		1	4	4
–		22		296		318		318	300	300
1,760		1,843		327		10,175		10,175	6,013	6,013
2,861		2,543		648		14,572		14,597	10,010	10,119

	Book value	Gross unrealized gains	Gross unrealized losses	1998 Market value
Investment account				
Securities issued or guaranteed by				
Canada	$ 945	$ 34	$ –	$ 979
Provinces	781	17	–	798
Municipalities or school boards	23	–	–	23
Debt securities	1,912	29	(33)	1,908
Equity securities				
Floating-rate preferred shares	16	–	–	16
Fixed-rate preferred shares	64	–	(3)	61
Other securities	579	3	(23)	559
Loan substitutes	77	1	–	78
Total of investment account	$ 4,397	$ 84	$ (59)	$ 4,422

4. IMPAIRED LOANS

The table below sets out impaired loans. The balance of impaired loans was reduced, as applicable, by the related allowances.

As at October 31, they amounted to:

			1998	1997
	Impaired loans	Allowance	Carrying amount	Carrying amount
Private impaired loans				
DOMESTIC				
Residential mortgages	$ 90	$ 14	$ 76	$ 74
Personal loans	84	28	56	42
Small business loans	154	42	112	125
Corporate loans	59	59	–	7
Commercial loans	410	194	216	190
Real estate loans	140	109	31	38
Other loans	6	6	–	–
	$ 943	$ 452	$ 491	$ 476
INTERNATIONAL				
Commercial loans – United States	$ 55	$ 19	$ 36	$ –
Real estate loans – United States	18	7	11	8
Other loans	21	14	7	8
	$ 94	$ 40	$ 54	$ 16
General allowance for credit risk [1]	–	500	(500)	(200)
Total private impaired loans	$ 1,037	$ 992	$ 45	$ 292
Loans to designated countries	42	40	2	5
Total impaired loans	$ 1,079	$ 1,032	$ 47	$ 297

Foreclosed assets held for sale in settlement of impaired loans which are included in total impaired loans together with the related allowance for credit losses amounted to $61 million and $5 million respectively as at October 31, 1998 compared to $122 million and $12 million as at October 31, 1997.

(1) The general allowance for credit risk was taken for the Bank's loans in their entirety.

5. ALLOWANCE FOR CREDIT LOSSES

The changes made to allowances during the year were as follows:

				1998	1997
	Specific allowance	General allowance for credit risk	Designated countries (loans and securities)	Total	Total
Allowance at beginning of year	$ 583	$ 200	$ 56	$ 839	$ 751
Provision for credit losses charged to income	193	–	–	193	290
Adjustment to general allowance for credit risk [a]	–	300	–	300	–
Write-offs	(329)	–	1	(328)	(242)
Recoveries	45	–	–	45	40
Allowance at end of year	$ 492	$ 500	$ 57	$ 1,049	$ 839
Portion related to loans	$ 492	$ 500	$ 40	$ 1,032	$ 835
Portion related to securities	$ –	$ –	$ 17	$ 17	$ 4

(a) In accordance with the guidance provided by the Superintendent described in Note 1, the Bank increased its general allowance for credit risk by $300 million. This amount, less income taxes of $117 million, was recorded under retained earnings.

6. PREMISES AND EQUIPMENT

	Cost	Accumulated amortization	1998 Net book value	1997 Net book value
Land	$ 21	$ –	$ 21	$ 21
Buildings	223	71	152	154
Equipment and furniture	367	279	88	87
	$ 611	$ 350	$ 261	$ 262
Leasehold improvements			83	85
			$ 344	$ 347
Amortization for the year charged to the Consolidated Statement of Income			$ 51	$ 49

7. OTHER ASSETS

	1998	1997
Accrued interest	$ 359	$ 314
Deferred income taxes	164	172
Prepaid expenses and other receivables	416	533
Goodwill less accumulated amortization of $60 (1997: $67)	82	154
Other	832	697
	$ 1,853	$ 1,870
Amortization of goodwill for the year charged to the Consolidated Statement of Income	$ 10	$ 11

8. DEPOSITS

	Payable on demand	Payable after notice	Payable on a fixed date	1998 Total	1997 Total
Personal	$ 874	$ 4,918	$ 14,421	$ 20,213	$ 20,724
Business and government	3,382	5,490	9,590	18,462	13,587
Deposit-taking institutions	119	25	9,207	9,351	8,959
	$ 4,375	$ 10,433	$ 33,218	$ 48,026	$ 43,270

9. OTHER LIABILITIES

	1998	1997
Accrued interest	$ 710	$ 662
Current income taxes	103	194
Liabilities of a subsidiary	213	317
Non-controlling interest	523	466
Trade and other payables	1,202	1,447
Other	421	514
	$ 3,172	$ 3,600

10. BANK DEBENTURES

The debentures, subordinated in right of payment to the claims of depositors and certain other creditors, consist of:

Maturity date		Interest rate	Characteristics	1998	1997
June	1998	10.875%	Convertible into 10 7/8% deposit notes at the Bank's option; interest payable semi-annually on June 1 and December 1	$ –	$ 9
February	1999	5.60%	Yen 5 billion; interest payable annually on February 23	–	59
April	1999	7.325%	Yen 2 billion/AUD 18.3 million equivalent (yen 5 billion/AUD 45.7 million equivalent in 1997); interest payable annually in AUD at the rate indicated for the AUD equivalent on April 21	26	59
April	2001	10.50%	Interest payable semi-annually on April 5 and October 5; not redeemable prior to maturity	17	30
June	2001	12.50%	Convertible into 2,391,600 common shares; redeemable at the Bank's option on certain conditions; interest payable semi-annually on June 5 and December 5	20	20
December	2003	7.50%	Not redeemable by the Bank prior to maturity; interest payable semi-annually on June 30 and December 30	125	125
August	2004	8.125%	US $250 million; not redeemable by the Bank prior to maturity unless the debentures become subject to foreign taxes; interest payable semi-annually on February 15 and August 15	386	351
October	2004	6.92%	Yen 2 billion/£9 million equivalent (yen 5 billion/£22 million equivalent in 1997); until October 25, 2000, interest of 6.92% payable in £ at the rate indicated for the £ equivalent, thereafter payable annually in yen at the Japanese long-term prime rate plus 1% on October 25; redeemable at the Bank's option on October 25, 1999	27	59
October	2004	7.00%	Yen 4 billion/£18 million equivalent (yen 5 billion/£22.1 million equivalent in 1997); interest payable annually in £ at the rate indicated for the £ equivalent on October 31; redeemable at the Bank's option on October 31, 1999	53	59
October	2011	7.50%	Not redeemable prior to October 17, 2001; interest payable semi-annually on April 17 and October 17 at a rate of 7.50% until October 17, 2006. Thereafter, interest payable at an annual rate equal to the 90-day Bankers' Acceptance Rate plus 1%	150	150
February	2087	floating	US $105 million bearing interest at an annual rate of 1/8% above LIBOR; interest payable semi-annually on February 28 and August 31; redeemable at the Bank's option as of February 28, 1993	162	148
				$ 966	$ 1,069

The debenture maturities are as follows:

1999	$ 26
2000	–
2001	$ 37
2002	–
2003	$ 125
2004 and thereafter	$ 778

11. CAPITAL STOCK

Authorized

FIRST PREFERRED SHARES
An unlimited number of shares, without par value, issuable for a maximum aggregate consideration of $1 billion

SECOND PREFERRED SHARES
15,000,000 shares, without par value, issuable for a maximum aggregate consideration of $300 million

COMMON SHARES
An unlimited number of shares, without par value, issuable for a maximum aggregate consideration of $3 billion

Issued and fully paid

			1998	1997
First Preferred Shares				
–	shares, Series 5	(1997: 286,610)	$ –	$ 29
–	shares, Series 7	(1997: 422,633)	–	10
–	shares, Series 8	(1997: 789,638)	–	20
3,680,000	shares, Series 10	(1997: 3,680,000)	92	92
4,000,000	shares, Series 11	(1997: 4,000,000)	100	100
5,000,000	shares, Series 12	(1997: 5,000,000)	125	125
			$ 317	$ 376
171,616,217	common shares	(1997: 170,461,483)	1,327	1,309
			$ 1,644	$ 1,685

The Bank paid the following dividends:

	(dividends per share in dollars)				
	1998	1997	1996	1995	1994
Common shares	$ 0.66	$ 0.575	$ 0.49	$ 0.40	$ 0.40
First Preferred Shares					
Series 5	$ 3.9531	$ 3.3670	$ 4.8235	$ 5.9462	$ 4.4495
Series 7	1.03065	0.8777	1.2576	1.5503	1.1601
Series 8	0.9883	0.8417	1.2059	1.4865	1.1125
Series 9	–	–	–	2.275771	2.3750
Series 10	2.1875	2.1875	2.1875	2.1875	2.1875
Series 11	2.00	2.00	2.00	2.00	2.00
Series 12	1.625	1.625	1.625	1.625	1.05625

Issue of common shares (amounts in dollars)
During the year ended October 31, 1998, 1,100,883 common shares were issued under the Dividend Reinvestment and Share Purchase Plan and the Stock Option Plan for an aggregate consideration of $16,063,252. In addition, 53,851 common shares were issued for an aggregate consideration of $1,653,227 relating to the acquisition of an interest in a brokerage firm.

During the year ended October 31, 1997, 3,310,102 common shares were issued under the Dividend Reinvestment and Share Purchase Plan and the Stock Option Plan for an aggregate consideration of $41,494,617.

Reserved common shares (amounts in dollars)
As at October 31, 1998, 2,391,600 common shares (1997: 2,391,600) were reserved for future conversion, 5,894,231 common shares (1997: 6,196,398) were reserved under the Dividend Reinvestment and Share Purchase Plan and 5,902,002 common shares (1997: 6,700,718) were reserved under the Stock Option Plan. As at October 31, 1998, 2,401,602 options were outstanding with a strike price ranging between $9.50 and $13.50 and maturities between December 1998 and December 2006. During the fiscal year, 798,716 options were exercised at strike prices ranging from $9.50 to $13.50. As at October 31, 1998, 716,077 options could be exercised.

Redemption of preferred shares
On October 15, 1998, the Bank redeemed all its First Preferred Shares, Series 5, 7 and 8 for an aggregate consideration of $58,967,775.

CAPITAL STOCK (cont.)

Characteristics of first preferred shares (amounts in dollars)

Series 5

Redeemable at $100 per share plus accrued and unpaid dividends; cumulative preferential dividends at a quarterly rate equal to one quarter of 70% of the average of the Bank's Prime Lending Rate in effect on each day during the three months ending on the first day of the month preceding the month in which the dividend payment is to be made.

Series 7

Redeemable at $25 per share plus accrued and unpaid dividends; cumulative preferential dividends at a quarterly rate equal to one quarter of 73% of the average of the Bank's Prime Lending Rate in effect on each day during the three months ending on the first day of the month preceding the month in which the dividend payment is to be made.

Series 8

Redeemable at $25 per share plus accrued and unpaid dividends; cumulative preferential dividends at a quarterly rate equal to one quarter of 70% of the average of the Bank's Prime Lending Rate in effect on each day during the three months ending on the first day of the month preceding the month in which the dividend payment is to be made.

Series 10

Redeemable at the Bank's option on or after November 16, 2001 at $25 per share in cash plus accrued and unpaid dividends, or by conversion into common shares in accordance with the privileges and conditions related to such preferred shares; non-cumulative preferential dividends, payable quarterly in an amount of $0.546875 per share.

Convertible at the holder's option on or after February 18, 2002 into common shares or into another series of preferred shares if the Bank's Board of Directors should decide, by resolution at least 30 days prior to February 18, 2002, to authorize a further series of first preferred shares, subject to the prior approval of the Superintendent. The Bank may, upon notice of no less than two business days prior to the conversion date, redeem the preferred shares to be converted.

Series 11

Redeemable at the Bank's option on or after February 15, 2002 at $25 per share in cash plus accrued and unpaid dividends, or by conversion into common shares in accordance with the privileges and conditions related to such preferred shares; non-cumulative preferential dividends, payable quarterly in an amount of $0.50 per share.

Convertible at the holder's option on or after May 15, 2002 into common shares or into another series of preferred shares if the Bank's Board of Directors should decide, by resolution at least 30 days prior to February 15, 2002, to authorize a further series of first preferred shares, subject to the prior approval of the Superintendent. The Bank may, upon notice of no less than two business days prior to the conversion date, redeem the preferred shares to be converted.

Series 12

Redeemable at the Bank's option on or after May 15, 2001 at $25 per share in cash plus a premium, if redeemed before May 15, 2003, together with accrued and unpaid dividends, in accordance with the privileges and conditions related to such preferred shares and subject to the prior approval of the Superintendent; non-cumulative preferential dividends, payable quarterly in an amount of $0.40625 per share.

Convertible at the Bank's option on or after May 15, 2001 into common shares, subject to the approval of the stock exchanges on which any shares of the Bank are listed.

Convertible at the holder's option on or after May 15, 2004 into common shares in accordance with the privileges and conditions related to such preferred shares, or into another series of preferred shares if the Bank's Board of Directors should decide, by resolution at least 30 days prior to May 15, 2004, to constitute a further series of first preferred shares, subject to the prior approval of the Superintendent. The Bank may, upon notice of no less than two business days prior to the conversion date, redeem the preferred shares to be converted.

12. PENSION PLANS

The Employee Pension Plan of National Bank of Canada provides for the payment of benefits based on the length of service and final average earnings of the employees covered. According to the latest actuarial valuation of the plan conducted as at December 31, 1997, accrued pension benefits, projected as at October 31, 1998, were $800 million and the adjusted market value of the assets of the plan as at October 31, 1998 amounted to $925 million. The pension expense included in the Statement of Income amounted to $6.6 million (1997: $1.6 million), taking into account the amortization on a straight-line basis of the experience gains and losses over a 14-year period and the funding excess existing on the date the accounting policy came into effect.

13. WRITE-OFF OF GOODWILL

During the fiscal year, the Bank determined that the $64 million unamortized balance of goodwill from the acquisition of General Trust of Canada had suffered a permanent impairment in value owing to profound changes in financial markets, slower-than-projected yields and the Bank's business plans. To establish the amount of this permanent impairment, the Bank took expected non-discounted cash flows into account. Accordingly, the unamortized balance of goodwill was written off in the Consolidated Statement of Income.

14. INCOME TAXES

Total income taxes reported in the consolidated financial statements are as follows:

	1998	1997
Consolidated Statement of Income		
Income taxes	$ 256	$ 238
Consolidated Statement of Retained Earnings		
Income taxes related to:		
Adjustment to general allowance for credit risk	(117)	–
Dividends on Preferred Shares, Series 10, 11 and 12	1	1
Unrealized foreign currency translation gains (losses)	(27)	(10)
	(143)	(9)
	$ 113	$ 229
Current and deferred income taxes are as follows:		
Current	$ 195	$ 247
Deferred	(82)	(18)
	$ 113	$ 229

The Bank's effective income tax rate, on income before income taxes, was calculated as follows:

	1998		1997	
Income before income taxes	$ 603	100.0%	$ 596	100.0%
Income taxes at Canadian statutory income tax rate	$ 235	39.0%	$ 232	39.0%
Increase (reduction) in income tax rate due to:				
Tax-exempt income from securities, mainly dividends from Canadian corporations	(12)	(2.1)	(9)	(1.5)
Rate applicable to subsidiaries abroad	(9)	(1.5)	2	0.3
Federal large corporations tax and surtax	9	1.5	10	1.7
Other items	33	5.5	3	0.5
	21	3.4	6	1.0
Income taxes and effective income tax rate	$ 256	42.4%	$ 238	40.0%

15. NET INCOME PER COMMON SHARE

Basic net income per share was calculated on the basis of the net income available for holders of common shares, less dividends on preferred shares, and the average number of common shares outstanding of 171,223,000 in 1998 (1997: 169,432,000).

Fully diluted net income per share was calculated on the basis of the net income for holders of common shares, less dividends on non-convertible preferred shares, and the average number of common shares of 173,615,000 in 1998 (1997: 171,824,000), assuming that all securities convertible at the holder's option (except for Preferred Shares, Series 10, 11 and 12) were converted at the beginning of each fiscal year.

16. COMMITMENTS

As at October 31, 1998, minimum commitments under leases, a service contract for outsourced information technology services, and equipment and furniture leasing agreements were as follows:

	Premises	Service contract	Equipment and furniture	Total
1999	$ 80	$ 138	$ 7	$ 225
2000	70	84	6	160
2001	62	84	2	148
2002	53	–	–	53
2003	46	–	–	46
2004 and thereafter	264	–	–	264
	$ 575	$ 306	$ 15	$ 896

17. COMMITMENTS TO EXTEND CREDIT

In the normal course of its business, the Bank enters into commitments to extend credit in order to meet the financial needs of its customers.

As at September 30	1998	1997
Guarantees, letters of credit and trade-related contingencies	$ 2,409	$ 1,614
Sale and repurchase agreements	771	946
Commitments to extend credit	15,702	14,158

Guarantees, letters of credit and trade-related contingencies are firm commitments by the Bank to make the related payments or guarantee the execution of non-financial commitments on behalf of a client who is unable to meet its contractual obligations to a third party. The credit risk they represent is considered equivalent to loans. Documentary letters of credit, which are used in international trade and usually issued on behalf of an importer, enable a third party such as an exporter to draw drafts on the Bank up to a pre-set amount under specific terms and conditions. The amounts are collateralized by the delivery of the underlying goods.

Sale and repurchase agreements represent the mortgage loans sold under the mortgage-backed securities program, provided for in the National Housing Act, which the Bank will repurchase when the securities mature.

Commitments to extend credit represent the unused portions of credit authorizations granted in the form of loans, bankers' acceptances or other credit instruments. The Bank is required at all times to make the unused portion of the authorization available, subject to certain conditions.

18. DERIVATIVE FINANCIAL INSTRUMENTS

The Bank uses derivative instruments for asset/liability management and for trading purposes. The derivatives used to manage the balance sheet serve to protect net interest income against the risk of fluctuations in interest and exchange rates. Trading activities enable customers to manage their risks and also include proprietary trading undertaken by the Bank.

The various derivative financial instruments listed in the tables below are defined as follows:

Interest rate and cross-currency swaps are transactions that generally involve the contractual exchange of fixed and floating rate interest payment obligations and/or currencies on a specified amount of notional principal for a specified period of time.

Forward rate agreements are contracts fixing an interest rate to be paid or received, calculated on a notional principal amount with a specified maturity commencing at a specified future date.

Foreign exchange forward contracts are commitments to purchase or sell foreign currencies for delivery at a specified date in the future at a fixed rate.

Financial futures are future commitments to purchase or deliver securities or money market instruments on a specified future date at a specified price. Futures are traded in standardized amounts on organized exchanges and are subject to daily cash margining.

Foreign currency and interest rate options are agreements between two parties in which the writer of the option grants the buyer the future right, but not the obligation, to buy or to sell, at or by a specified date, a specific amount of a derivative financial instrument at a price agreed when the option is arranged. The writer receives a premium for selling this instrument.

Notional principal amounts, upon which payments are based, are not indicative of the credit risk associated with derivative financial instruments.

DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

As at September 30, the type and maturity by type of contract were as follows:

	Contracts held for trading purposes	Remaining term to maturity						Total contracts 1998	Total contracts 1997
		3 months and under	3 to 6 months	6 to 12 months	1 to 3 years	3 to 5 years	Over 5 years		
Foreign exchange contracts									
OTC contracts									
Forwards	$ 40,893	$ 24,666	$ 5,972	$ 7,576	$ 5,545	$ 553	$ –	$ 44,312	$ 26,800
Swaps	333	44	192	56	758	1,188	–	2,238	488
Options purchased	14,632	8,085	2,695	2,777	1,027	48	–	14,632	9,348
Options written	14,857	7,991	2,973	3,094	795	4	–	14,857	8,342
TOTAL	70,715	40,786	11,832	13,503	8,125	1,793	–	76,039	44,978
Exchange-traded contracts									
Futures									
Long positions	37	31	6	–	–	–	–	37	1
Short positions	438	291	76	64	7	–	–	438	467
Options purchased	331	325	6	–	–	–	–	331	51
Options written	251	210	32	9	–	–	–	251	217
TOTAL	1,057	857	120	73	7	–	–	1,057	736
Interest rate contracts									
OTC contracts									
Forward rate agreements	24,519	22,756	1,510	699	66	–	–	25,031	12,088
Swaps	25,707	18,506	3,428	7,167	14,689	7,044	1,513	52,347	26,632
Options purchased	7,489	3,620	3,151	1,171	869	93	–	8,904	1,559
Options written	9,386	3,732	3,907	2,551	309	5	–	10,504	2,143
TOTAL	67,101	48,614	11,996	11,588	15,933	7,142	1,513	96,786	42,422
Exchange-traded contracts									
Futures									
Long positions	6,558	706	3,797	1,857	553	–	–	6,913	3,914
Short positions	4,646	3,235	1,995	72	104	–	–	5,406	9,086
Options purchased	12,228	10,003	2,125	3,650	–	–	–	15,778	6,365
Options written	20,169	13,016	3,453	7,249	–	–	–	23,718	2,576
TOTAL	43,601	26,960	11,370	12,828	657	–	–	51,815	21,941
Equity contracts									
OTC contracts									
Swaps	11	9	26	–	6	–	–	41	33
Options purchased	289	46	150	59	32	100	11	398	79
Options written	238	1	–	20	105	112	–	238	–
TOTAL	538	56	176	79	143	212	11	677	112
Exchange-traded contracts									
Futures									
Long positions	23	23	–	–	–	–	–	23	9
Short positions	348	348	–	–	–	–	–	348	223
Options purchased	9	9	–	–	–	–	–	9	–
Options written	15	15	–	–	–	–	–	15	–
TOTAL	395	395	–	–	–	–	–	395	232
Commodity contracts									
Exchange-traded contracts									
Long positions	456	390	66	–	–	–	–	456	–
Short positions	1,434	1,252	182	–	–	–	–	1,434	–
TOTAL	1,890	1,642	248	–	–	–	–	1,890	–
1998 TOTAL	$185,297	$119,310	$ 35,742	$ 38,071	$ 24,865	$ 9,147	$ 1,524	$228,659	
1997 TOTAL	$ 86,717	$ 59,444	$ 14,375	$ 16,788	$ 11,928	$ 7,012	$ 874		$110,421

DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

Credit risk on derivative financial instruments is the risk of a financial loss occurring as a result of a default of a counterparty on its obligations to the Bank. The current replacement cost, which is the positive fair value of all outstanding derivative financial instruments, represents the Bank's maximum derivative credit exposure. Potential future exposure is calculated in accordance with the requirements of the Superintendent by applying factors to the notional principal amount of the instruments. The credit equivalent amount is calculated taking into account the current replacement cost of all outstanding contracts in a gain position, potential future exposure and the impact of master netting agreements. The risk-weighted equivalent is the credit equivalent amount multiplied by the counterparty risk factors prescribed by the Superintendent.

As at September 30, credit risk exposure on the derivatives portfolio was as follows:

					1998					1997
	Notional amount	Replacement cost	Future credit risk	Credit equivalent	Risk-weighted equivalent	Notional amount	Replacement cost	Future credit risk	Credit equivalent	Risk-weighted equivalent
Foreign exchange contracts	$ 77,096	$ 643	$ 858	$ 1,217	$ 443	$ 45,714	$ 245	$ 428	$ 580	$ 158
Interest rate contracts	148,601	266	147	362	94	64,363	237	100	304	77
Equity contracts	1,072	107	208	339	41	344	47	10	57	18
Commodity contracts	1,890	–	–	–	–	–	–	–	–	–
TOTAL	$228,659	$ 1,016	$ 1,213	$ 1,918	$ 578	$110,421	$ 529	$ 538	$ 941	$ 253

As at September 30, the distribution of risk exposure by counterparty was as follows:

			1998	1997
	Replacement cost	Future credit risk	Credit equivalent	Credit equivalent
OECD governments	$ 8	$ 11	$ 18	$ 6
OECD banks	1,127	888	1,085	712
Other	541	314	815	223
	$ 1,676	$ 1,213	$ 1,918	$ 941

19. CREDIT RISK EXPOSURE

The risk-weighted capital ratios are determined pursuant to guidelines issued by the Superintendent based on standards prescribed by the Bank for International Settlements (BIS).

Regulatory capital ratios are calculated by dividing Tier 1 and total capital by risk-weighted assets. Risk-weighted assets are determined by applying risk weights to balance sheet assets and derivative financial instruments according to the relative credit risk of the counterparty.

	Balance sheet amount	Risk weight (%)	Risk-weighted balance 1998	Risk-weighted balance 1997
On-balance sheet items				
Cash and deposits with Bank of Canada	$ 530	0	$ –	$ –
Deposits with regulated financial institutions	4,322	20-100	882	981
Securities issued or guaranteed by Canada, provinces, municipalities or school boards	8,790	0-20	111	105
Other securities	5,782	0-100	472	2,177
Mortgage loans	14,876	0-100	4,335	4,200
Other loans and bankers' acceptances	34,166	0-100	26,839	24,475
Other assets	2,197	0-100	1,771	1,749
	$ 70,663		$ 34,410	$ 33,687

As at September 30	Notional amount	Credit conversion factor (%)	Risk weight (%)	Risk-weighted equivalent 1998	Risk-weighted equivalent 1997
Commitments to extend credit					
Guarantees, letters of credit and trade-related contingencies	$ 2,409	50-100	20-100	$ 1,645	$ 1,193
Sale and repurchase agreements	771	100	0	–	–
Commitments to extend credit	15,702	0-50	0-100	2,819	2,293
	$ 18,882			$ 4,464	$ 3,486

CREDIT RISK EXPOSURE (cont.)

As at September 30	Notional amount	Replacement cost	Future credit risk	Risk weight (%)	Risk-weighted equivalent 1998	Risk-weighted equivalent 1997
Derivative financial instruments						
Foreign exchange contracts						
Swaps	$ 2,238			0-50		
Options purchased	14,963			0-50		
Options written	15,108			0-50		
Futures	475			0-50		
Forwards	44,312			0-50		
	$ 77,096	$ 643	$ 858		$ 443	$ 158
Interest rate contracts						
Swaps	52,347			0-50		
Options purchased	24,682			0-50		
Options written	34,222			0-50		
Futures	12,319			0-50		
Forward rate agreements	25,031			0-50		
	$148,601	$ 266	$ 147		$ 94	$ 77
Equity contracts						
Swaps	41			0-50		
Options purchased	407			0-50		
Options written	253			0-50		
Futures	371			0-50		
	$ 1,072	$ 107	$ 208		$ 41	$ 18
Commodity contracts						
Futures	$ 1,890	$ –	$ –	0-50	$ –	$ –
Total derivative financial instruments	$228,659	$ 1,016	$ 1,213		$ 578	$ 253
Market risk					$ 1,195	$ –
Total risk-weighted assets					$ 40,647	$ 37,426
Ratios					1998	1997
Tier 1 capital					7.7%	8.1%
Tier 2 capital					3.0%	3.2%
Total capital					10.7%	11.3%

20. INTEREST RATE SENSITIVITY POSITION

Analyzing interest rate sensitivity gaps is one of the methods used by the Bank to control interest rate risk.

The following breakdown of assets and liabilities by maturity illustrates the sensitivity of the Bank's balance sheet to interest rate fluctuations as at October 31, 1998.

	Floating rate	3 months and under	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Non-interest sensitive	Total
ASSETS								
Cash resources	$ 1,114	$ 3,346	$ 212	$ –	$ –	$ –	$ 180	$ 4,852
Securities	–	3,803	2,033	2,684	2,861	2,543	648	14,572
Loans	16,510	10,809	2,433	3,972	11,688	(107)	1,079	46,384
Other assets	(2,884)	6,749	508	492	–	–	(10)	4,855
	14,740	24,707	5,186	7,148	14,549	2,436	1,897	70,663
LIABILITIES								
Deposits	8,930	14,048	5,888	9,319	8,616	143	1,082	48,026
Subordinated debt	–	–	189	80	37	660	–	966
Other liabilities	(1,070)	13,670	1,017	802	1,573	2,267	717	18,976
Shareholders' equity	–	–	–	–	192	125	2,378	2,695
	7,860	27,718	7,094	10,201	10,418	3,195	4,177	70,663
On-balance sheet gap	6,880	(3,011)	(1,908)	(3,053)	4,131	(759)	(2,280)	–
Derivative financial instruments	–	(8,650)	1,916	6,128	(257)	748	334	219
TOTAL	6,880	(11,661)	8	3,075	3,874	(11)	(1,946)	219
Position in Canadian dollars								
On-balance sheet total	5,286	(2,567)	31	104	4,219	(261)	(2,688)	4,124
Derivative financial instruments	–	(4,478)	883	320	(1,200)	413	95	(3,967)
Total	5,286	(7,045)	914	424	3,019	152	(2,593)	157
Position in foreign currency								
On-balance sheet total	1,594	(444)	(1,939)	(3,157)	(88)	(498)	408	(4,124)
Derivative financial instruments	–	(4,172)	1,033	5,808	943	335	239	4,186
Total	1,594	(4,616)	(906)	2,651	855	(163)	647	62
1998 TOTAL	$ 6,880	$(11,661)	$ 8	$3,075	$ 3,874	$ (11)	$(1,946)	$ 219
1997 TOTAL	$ 6,197	$ (2,409)	$ (547)	$ (164)	$ (29)	$ 475	$(3,357)	$ 166

	3 months and under	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years
Interest rate (1)					
ASSETS					
Securities	5.53%	4.85%	4.92%	5.59%	5.82%
Loans	5.77	6.86	6.74	7.04	6.73
Average weighted yield on assets	5.71	5.95	6.00	6.76	5.94
LIABILITIES					
Deposits	5.37	5.27	5.50	6.03	6.36
Subordinated debt	–	5.05	6.97	11.58	7.87
Average weighted cost of liabilities	5.37	5.26	5.51	6.05	7.60
NET TOTAL	14.17%	3.37%	4.32%	7.79%	5.31%

(1) Represents the risk-weighted average effective yield, taking into account the contractual repricing date or maturity date, whichever is earlier.

21. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following tables present the fair value of on and off-balance sheet financial instruments based on the valuation methods and assumptions set out below.

Fair value represents the amount at which a financial instrument could be exchanged in an arm's length transaction between willing parties under no compulsion to act and is best evidenced by a quoted market price. If no quoted market prices are available, the fair values presented are estimates derived using present value or other valuation techniques and may not be indicative of the net realizable value.

The fair values disclosed exclude the values of assets and liabilities that are not considered financial instruments such as land, buildings, equipment and furniture. Due to the judgment used in applying a wide range of acceptable valuation techniques and estimations in calculating fair value amounts, fair values are not necessarily comparable among financial institutions. The calculation of estimated fair values is based on market conditions at a specific point in time and may not be reflective of future fair values.

As at October 31			1998			1997
	Book value	Fair value	Difference	Book value	Fair value	Difference
ASSETS						
Cash resources	$ 4,852	$ 4,852	$ –	$ 4,476	$ 4,476	$ –
Securities	14,572	14,597	25	10,010	10,119	109
Loans	46,384	46,660	276	47,259	47,691	432
Other assets	4,855	4,855	–	4,490	4,490	–
TOTAL	$ 70,663	$ 70,964	$ 301	$ 66,235	$ 66,776	$ 541
LIABILITIES						
Deposits	$ 48,026	$ 48,793	$ 767	$ 43,270	$ 44,132	$ 862
Subordinated debt	966	1,028	62	1,069	1,111	42
Other liabilities	18,976	18,976	–	19,136	19,136	–
TOTAL	$ 67,968	$ 68,797	$ 829	$ 63,475	$ 64,379	$ 904

The fair value of derivatives is as follows:

			Contracts held for trading purposes			Contracts held for non-trading purposes	1998 TOTAL	1997 TOTAL
	Gross assets	Gross liabilities	Net amount	Gross assets	Gross liabilities	Net amount	Net amount	Net amount
Interest rate contracts	$ 136	$ 159	$ (23)	$ 299	$ 152	$ 147	$ 124	$ 94
Foreign exchange contracts	1,577	1,417	160	2,640	1,330	1,310	1,470	83
Equity contracts	27	2	25	49	–	49	74	46
TOTAL	$ 1,740	$ 1,578	$ 162	$ 2,988	$ 1,482	$ 1,506	$ 1,668	$ 223

The following methods and assumptions were used to estimate the fair value of the financial instruments:

Cash resources, other assets and other liabilities: Due to their short-term maturity, the fair values of these financial instruments are assumed to be equal to their carrying values.

Securities: The fair values of securities are presented in Note 3 to the financial statements. They are based on quoted market prices. If quoted market prices are not available, fair values are estimated using the quoted market prices of similar securities.

Loans: The fair values of floating-rate loans are assumed to be equal to their carrying values. The fair values of other loans are estimated using a discounted cash flow calculation that uses market interest rates currently charged for similar new loans as at the balance sheet date applied to expected maturity amounts (adjusted for any prepayments).

FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Deposits: The fair values of fixed-rate deposits are determined by discounting the contractual cash flows, using market interest rates currently offered for deposits with the same remaining terms. The fair values of deposits with no stated maturity are assumed to be equal to their carrying values.

Subordinated debt: The fair value of subordinated debt is determined by discounting the contractual cash flows, using market interest rates currently offered for similar financial instruments with the same remaining terms to maturity.

Derivatives: The fair values of derivatives are determined, before the impact of master netting agreements, using various methodologies including quoted market prices, prevailing market rates for instruments with similar characteristics and maturities, net present value analysis or other pricing models as appropriate.

22. RELATED PARTY TRANSACTIONS

In the normal course of its business, the Bank provides various banking services to its subsidiaries which are recorded at the exchange value reflecting the consideration determined and accepted by both parties.

The Bank also grants loans to its directors, officers and staff under various conditions. Total outstanding loans of this type amounted to:

	1998	1997
Loans to directors (August 31)	$ 276	$ 270
Loans to officers and staff (October 31)	$ 443	$ 475

23. CONTINGENCIES

Litigation

Various legal proceedings are pending against the Bank and its subsidiaries. In management's opinion, the aggregate amount of potential liability related thereto will not have a material impact on the Bank's financial position.

Uncertainty related to Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. The Bank has devoted considerable resources to modifying or replacing its major computer systems in order to ensure that they are year 2000 compliant. However, it is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers or other third parties, will be fully resolved.

24. DOMESTIC AND INTERNATIONAL OPERATIONS

Domestic operations encompass all business carried on by the Bank's network of branches and lending centres in Canada, treasury operations on Canadian financial markets and international commercial operations carried out by the Canadian branch network.

International operations comprise transactions on international financial markets entered into with public and private sector entities in Canada and abroad, and with governments and their agencies.

			International					
	Domestic		United States		Other		TOTAL	
	1998	1997	1998	1997	1998	1997	1998	1997
Net interest income [a]	$ 1,131	$ 1,143	$ 130	$ 118	$ 49	$ 63	$ 1,310	$ 1,324
Other income	1,099	1,024	37	29	6	3	1,142	1,056
Provision for credit losses	123	246	70	32	–	12	193	290
Non-interest expenses	1,565	1,414	70	55	18	20	1,653	1,489
Income taxes [a]	243	205	11	25	5	13	259	243
Non-controlling interest	31	16	–	–	–	–	31	16
Net income	$ 268	$ 286	$ 16	$ 35	$ 32	$ 21	$ 316	$ 342
Average total assets	$ 56,482	$ 47,062	$ 6,093	$ 4,997	$ 3,298	$ 3,626	$ 65,873	$ 55,685

(a) Net interest income was grossed up by $3 million ($5 million in 1997) to bring the tax-exempt income earned on certain securities in line with the income on other financial instruments. An equal amount was added to income taxes.

25. COMPARISON WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN CANADA

The consolidated financial statements of the Bank are prepared in accordance with Canadian generally accepted accounting principles (GAAP), other than the accounting for the general allowance for credit risk which is in accordance with the accounting requirements of the Superintendent. The impact of the departure from Canadian GAAP to conform to the guidance provided by the Superintendent is described below.

Consolidated Balance Sheet

The following table shows the increases (decreases) in the Balance Sheet resulting from the application of the guidance provided by the Superintendent.

Description	Note	1998	1997
Loans	a	(300)	–
Other assets	a	117	–
Shareholders' equity	a	(183)	–

(a) As described in Note 5, the Bank increased its general allowance for credit risk. In accordance with the guidance provided by the Superintendent, this one-time adjustment was applied to retained earnings. The adjustment does not comply with Canadian GAAP. However, had the Bank not departed from Canadian GAAP to conform to the guidance provided by the Superintendent, loans would have increased by $300 million, deferred income taxes included in "Other assets" would have declined by $117 million and retained earnings would have risen by $183 million.

Consolidated Statement of Income

There was no impact on the Consolidated Statement of Income as reported, compared with Canadian GAAP.

Consolidated Statement of Changes in Shareholders' Equity

Except for the impact on shareholders' equity of $183 million, there was no impact on the Consolidated Statement of Changes in Shareholders' Equity as reported, compared with Canadian GAAP.

Consolidated Statement of Changes in Financial Position

There was no impact on the Consolidated Statement of Changes in Financial Position as reported, compared with Canadian GAAP.

26. COMPARISON WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES

The consolidated financial statements of the Bank are prepared in accordance with Canadian generally accepted accounting principles (GAAP), other than the accounting for the general allowance for credit risk which is in accordance with the accounting requirements of the Superintendent. Material differences with United States GAAP are described below.

Consolidated Balance Sheet

The following table shows the increases (decreases) in the Balance Sheet resulting from the application of U.S. GAAP.

Description	Note	1998	1997
Securities	a	25	109
Loans	c	300	–
Other assets	a,b,c	(99)	(16)
Other liabilities	b	71	69
Shareholders' equity	a,b,c	155	24

Consolidated Statement of Income

The following table shows the increases (decreases) in the Statement of Income resulting from the application of U.S. GAAP.

	Note	1998	1997
Net domestic income		316	342
Post-retirement benefits, net of income tax	b	(1)	(1)
Net U.S. income		315	341
Net income per common share – U.S. GAAP		$1.68	$1.86

a) Under Canadian GAAP, the Bank classifies securities as trading account securities if they are held for resale in the near term and as investment account securities in other cases. Investment account securities are recorded at amortized cost while trading account securities are reported at their fair value. According to the U.S. Statement of Financial Accounting Standards (SFAS) No. 115 regarding the accounting for securities, investment account securities would be separated into two categories: securities held to maturity and securities available for sale. Securities held to maturity include those that the Bank has the positive intent and ability to hold to maturity, and are reported at amortized cost. Securities available for sale include those that are not held to maturity and trading account securities. They are reported at fair value, with unrealized gains and losses excluded from income and reported in a separate component of shareholders' equity.

Had the Bank reported its investment account securities as at October 31, 1998 in accordance with U.S. GAAP, securities would have increased by $25 million, deferred income taxes included in "Other assets" would have declined by $10 million, and an after-tax net unrealized gain of $15 million would have been reported as a separate component of shareholders' equity.

As at October 31, 1997, securities would have risen by $109 million, deferred income taxes included in "Other assets" would have decreased by $43 million, and an after-tax net unrealized gain of $66 million would have been reported as a separate component of shareholders' equity.

b) According to SFAS No. 106 on employers' accounting for post-retirement benefits other than pensions for United States reporting purposes, the cost of post-retirement benefits other than pension plans are recognized in the same way as pension costs, namely, over the working lives of the employees covered, based on actuarial assumptions. In Canada, these costs are charged to income as incurred.

Had the Bank adopted this standard, other liabilities and deferred income taxes included in "Other assets" would have increased by $71 million and $28 million respectively and retained earnings and net income for the year would have declined by $43 million and $1 million respectively as at October 31, 1998.

As at October 31, 1997, had the Bank adopted this standard, other liabilities and deferred income taxes included in "Other assets" would have increased by $69 million and $27 million respectively and retained earnings and net income for the year would have declined by $42 million and $1 million respectively.

COMPARISON WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES (cont.)

c) As described in Note 5, the Bank increased its general allowance for credit risk. In accordance with the guidance provided by the Superintendent, this one-time adjustment was applied to retained earnings. The adjustment does not comply with U.S. GAAP. Had the Bank adopted U.S. GAAP, loans would have increased by $300 million, deferred income taxes included in "Other assets" would have declined by $117 million and retained earnings would have risen by $183 million. There was no impact on the Consolidated Statement of Income.

Consolidated Statement of Changes in Shareholders' Equity

Except for the impact on shareholders' equity owing to the above difference, there was no impact on the Consolidated Statement of Changes in Shareholders' Equity as reported, compared with U.S. GAAP.

Consolidated Statement of Changes in Financial Position

There was no material difference in the Consolidated Statement of Changes in Financial Position as reported, compared with U.S. GAAP, except for the additional information concerning the $2.0 billion of interest paid in 1998 ($1.8 billion in 1997) and the $153 million of income taxes paid in 1998 ($116 million in 1997).

STATISTICAL REVIEW

	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Balance sheet data										
Cash resources	$ 4,852	$ 4,476	$ 3,528	$ 5,174	$ 3,765	$ 3,204	$ 3,693	$ 1,883	$ 2,216	$ 2,206
Securities	14,572	10,010	8,414	7,285	6,071	5,985	4,273	3,899	3,129	2,842
Loans	46,384	47,259	37,935	33,795	32,226	30,692	30,003	28,360	27,420	25,322
Bankers' acceptances	2,658	2,273	1,725	1,293	1,255	1,081	940	1,335	2,151	2,618
Other assets	2,197	2,217	1,532	1,366	1,457	1,772	1,126	962	987	939
Total assets	$ 70,663	$ 66,235	$ 53,134	$ 48,913	$ 44,774	$ 42,734	$ 40,035	$ 36,439	$ 35,903	$ 33,927
Deposits	$ 48,026	$ 43,270	$ 40,125	$ 40,424	$ 36,850	$ 35,113	$ 33,433	$ 29,987	$ 28,929	$ 26,646
Other liabilities	18,976	19,136	9,494	4,895	4,253	4,476	3,645	3,451	3,976	4,295
Long-term debt										
Floating-capital notes	–	–	–	106	113	120	–	–	–	–
Bank debentures	966	1,069	1,016	1,177	1,241	1,037	969	806	727	765
Liabilities of subsidiaries	–	–	–	–	–	17	234	408	535	589
Capital stock										
Preferred	317	376	376	376	532	426	468	385	387	394
Common	1,327	1,309	1,268	1,234	1,207	1,083	906	905	904	828
Retained earnings	1,051	1,075	855	701	578	462	380	497	445	410
Total liabilities and shareholders' equity	$ 70,663	$ 66,235	$ 53,134	$ 48,913	$ 44,774	$ 42,734	$ 40,035	$ 36,439	$ 35,903	$ 33,927
Average assets	$ 65,873	$ 55,685	$ 49,239	$ 47,582	$ 43,160	$ 39,657	$ 38,908	$ 36,740	$ 36,040	$ 32,267
Average capital funds (1)	3,886	3,744	3,511	3,620	3,230	2,871	2,723	2,593	2,463	2,397
Income statement data										
Net interest income	$ 1,307	$ 1,319	$ 1,136	$ 1,170	$ 1,081	$ 996	$ 1,012	$ 972	$ 902	$ 927
Other income	1,142	1,056	970	712	719	635	541	472	439	381
Gross income	$ 2,449	$ 2,375	$ 2,106	$ 1,882	$ 1,800	$ 1,631	$ 1,553	$ 1,444	$ 1,341	$ 1,308
Provision for credit losses	193	290	235	255	275	325	570	270	250	442
Non-interest expenses	(5)1,589	1,489	1,413	1,229	1,168	1,042	1,016	919	868	785
Income taxes	256	238	130	146	131	81	(41)	64	54	55
Non-controlling interest	31	16	10	7	9	8	7	5	–	–
Net income	$ (5)380	$ 342	$ 318	$ 245	$ 217	$ 175	$ 1	$ 186	$ 169	$ 26

	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Common stock data										
Number of common shares at end of year (in thousands)	171,616	170,461	167,151	163,963	160,976	148,474	127,152	127,031	126,875	118,200
Number of common shareholders of record	32,902	34,433	36,549	39,053	41,974	46,121	49,200	56,901	60,911	64,478
Net income (loss) per share										
– Basic	$ (5) 2.07	$ 1.86	$ 1.76	$ 1.26	$ 1.12	$ 1.01	$ (0.29)	$ 1.20	$ 1.10	$ 0.01
– Fully diluted	$ (5) 2.05	$ 1.84	$ 1.74	$ 1.24	$ 1.10	$ 1.00	$ (0.29)	$ 1.19	$ 1.09	$ 0.01
Dividend per share	$ 0.66	$ 0.575	$ 0.49	$ 0.40	$ 0.40	$ 0.40	$ 0.70	$ 0.80	$ 0.80	$ 0.72
Stock trading range										
– High	31.25	20.30	13.90	11.88	11.63	10.75	12.75	11.38	14.00	15.13
– Low	20.10	13.20	10.38	8.63	8.25	7.25	7.38	7.00	7.13	11.00
– Close	23.05	20.15	13.00	11.00	9.38	10.50	8.13	11.13	7.13	14.00
Book value per share	$ 13.86	$ 13.99	$ 12.70	$ 11.88	$ 11.09	$ 10.41	$ 10.11	$ 11.03	$ 10.63	$ 10.48
Financial ratios										
Return on common shareholders' equity	(5) 14.1%	14.0%	14.5%	11.0%	10.5%	9.9%	(2.6)%	11.0%	9.8%	0.1%
Return on average assets	0.58%	0.62%	0.64%	0.51%	0.50%	0.44%	–	0.51%	0.47%	0.08%
Return on average capital funds	9.3%	10.5%	10.6%	8.3%	7.9%	7.3%	1.5%	8.7%	8.7%	3.3%
Capital ratios (BIS)										
– Tier 1	7.7%	8.1%	6.9%	6.8%	6.9%	(3) 6.2%	5.0%	5.2%	4.9%	4.8%
– Total	10.7%	11.3%	(2) 10.2%	10.4%	11.1%	(3) 9.6%	8.7%	8.8%	8.2%	8.1%
Other information										
Impaired loans, net	47	297	406	511	688	904	1,097	733	665	345
Number of Bank employees (full-time equivalent)[4]										
– In Canada	11,641	11,245	11,022	10,249	10,423	11,822	11,629	12,275	12,210	12,030
– Outside Canada	400	406	380	371	323	327	333	369	372	316
– LBG	1,895	1,676	1,425	1,578	1,481	1,398	1,339	1,293	1,291	1,478
Number of branches in Canada	646	637	632	629	641	650	652	662	650	625
Number of banking machines	747	738	712	624	551	496	482	454	397	335

(1) Average capital funds include common shareholders' equity, redeemable preferred shares and bank debentures.

(2) Taking into account the issue of $150 million in debentures on November 1, 1996.

(3) Taking into account the redemption of $100 million in debentures through the issue of common shares as at November 1, 1993.

(4) The basis for determining full-time equivalence was changed in 1996.

(5) Excluding the write-off of $64 million or 38¢ per share of goodwill.

SUBSIDIARIES AND AFFILIATED CORPORATIONS

As at October 31, 1998

Name	Principal office address	Percentage of voting and participating shares	Investment at cost (millions of $)
Subsidiaries			
Natcan Trust Company	Montreal, Canada	100%	$ 55
General Trust of Canada	Montreal, Canada	100%	$ 155
National Bank Life Insurance Company	Montreal, Canada	100%	$ 10
National Bank Financial Services (Investments) Inc.	Montreal, Canada	100%	$ –
NBC Export Development Corporation Inc.	Montreal, Canada	100%	$ –
Lévesque, Beaubien and Company Inc.	Montreal, Canada	75%	$ 137
– Lévesque Beaubien Geoffrion Inc.	Montreal, Canada	75%	$ –
National Bank Securities Inc.	Montreal, Canada	100%	$ 5
NBC Clearing Services Incorporated	Montreal, Canada	100%	$ –
Natcan Investment Management Inc.	Montreal, Canada	80%	$ 8
Kogeva International Investments Inc.	Montreal, Canada	80%	$ –
SIBN Inc.	Montreal, Canada	100%	$ 6
SIBN Calculus Inc.	Montreal, Canada	100%	$ –
Municipal Securities Inc.	Barrie, Canada	100%	$ –
National Bank Financial Planning Inc.	Montreal, Canada	100%	$ –
Alter Moneta Corporation	Longueuil, Canada	71%	$ –
Innocap Investment Management Inc.	Montreal, Canada	100%	$ 1
Mercantile Canada Finance B.V.	Amsterdam, Netherlands	100%	$ 6
NBC Holdings USA, Inc.	New York, United States	100%	$ 290
– National Canada Finance Corp.	New York, United States	100%	$ –
– National Canada Business Corp.	New York, United States	100%	$ –
– National Canada Corporation	New York, United States	100%	$ –
– National Canada Export Corporation	New York, United States	100%	$ –
NB Capital Corporation	New York, United States	100%	$ 283
NB Finance Ltd.	Hamilton, Bermuda	100%	$ 204
NatBC Holding Corporation	Florida, United States	100%	$ 21
– Natbank, National Association	Florida, United States	100%	$ –
Natcan Holdings International Limited	Nassau, Bahamas	100%	$ 5
– National Bank of Canada (International) Limited	Nassau, Bahamas	100%	$ –
Natcan Finance (Asia) Limited	Hong Kong, China	100%	$ 8
National Bank of Canada (Asia) Ltd.	Singapore, Singapore	100%	$ 3
Natcan Insurance Company Limited	Christ Church, Barbados	100%	$ 1
Affiliated corporations			
Natdev Inc.	Quebec City, Canada	50%	$ 1
National Bank Financial Services Inc.	Montreal, Canada	50%	$ 2
Cancap Preferred Corporation	Montreal, Canada	50%	$ –

DIRECTORS

André Bérard
Chairman of the Board and
Chief Executive Officer
National Bank of Canada
Montreal, Quebec

Pierre Bourgie
President and
Chief Executive Officer
Société Financière Bourgie Inc.
Outremont, Quebec

Gérard Coulombe
Senior Partner
Desjardins Ducharme
Stein Monast
Sainte-Marthe, Quebec

Michelle Courchesne
General Manager
Montreal Symphony Orchestra
Laval, Quebec

Léon Courville
President, Personal and Commercial Bank,
and Chief Operating Officer
National Bank of Canada
Outremont, Quebec

François Jean Coutu
President and Chief Operating Officer
The Jean Coutu Group (PJC) Inc.
Outremont, Quebec

Shirley A. Dawe
President
Shirley Dawe Associates Inc.
Toronto, Ontario

Nicole Diamond-Gélinas
Vice-President and
General Manager
Aspasie Inc.
Saint-Barnabé-Nord, Quebec

Jean Douville
Chairman of the Board and
Chief Executive Officer
UAP Inc.
Montreal, Quebec

Marcel Dutil
Chairman of the Board, President and
Chief Executive Officer
The Canam Manac Group Inc.
Outremont, Quebec

Paul Gobeil
Vice-Chairman of the Board
Métro-Richelieu Inc.
Montreal, Quebec

Donald M. Green
Chairman of the Board
ACD Tridon Inc.
Burlington, Ontario

Suzanne Leclair
President, Chief Executive Officer and
Chairwoman of the Board of Directors
Transit Truck Bodies Inc.
Laval, Quebec

Bernard Lemaire
Chairman of the Board
Cascades Inc.
Kingsey Falls, Quebec

Gaston Malette
Chairman of the Board
Malette Inc.
Timmins, Ontario

Léonce Montambault
Corporate Director
Sillery, Quebec

Gordon F. Osbaldeston
Professor Emeritus
Ivey School of Business
University of Western Ontario
London, Ontario

J.-Robert Ouimet
President and
Chief Executive Officer
Ouimet-Cordon Bleu Inc.
Montreal, Quebec

Robert Parizeau
Chairman of the Board
AON Parizeau Inc.
Montreal, Quebec

Michel Perron
Chairman of the Board and
Chief Executive Officer
Somiper Inc.
Westmount, Quebec

Raymond Royer
President and
Chief Executive Officer
Domtar Inc.
Île-Bizard, Quebec

Lino Saputo
Chairman of the Board and
Chief Executive Officer
Saputo Group Inc.
Montreal, Quebec

Claude F. Savoie
President
Acadian Construction (1991) Ltd.
Moncton, New Brunswick

Paul-Gaston Tremblay
President
Primo-Gestion Inc.
Chicoutimi, Quebec

Jean Turmel
President, Financial Markets, Treasury
and Investment Bank
National Bank of Canada
Outremont, Quebec

COMMITTEES OF THE BOARD OF DIRECTORS

EXECUTIVE COMMITTEE

The Executive Committee reviews the policies concerning the Bank's business and financial practices with respect to risk management and internal controls, the related annual reports and the updates made to the Management Proxy Circular and the Bank's Code of Ethics, and subsequently recommends the adoption thereof to the Board of Directors. It approves requests for donations and sponsorships presented to it. It examines the overall compensation policy and other employment conditions applicable to the Bank's employees and officers, excluding the Named Executive Officers, and recommends the approval thereof to the Board of Directors; it periodically examines officers' performance and makes recommendations to the Board of Directors regarding salary increases and short-term bonuses. As well, the Committee approves the investment policy of the Pool Fund for Participating Pension Plans, the actuarial valuation and the financial statements of these Plans and Pool Fund as well as the aggregate performance of the Pool Fund and its managers.

The Executive Committee is authorized to exercise the powers that come within the purview of the Board of Directors between meetings of the Board of Directors, except for those assigned exclusively to the Bank's directors under the Bank Act. When necessary, it also exercises the functions of the Credit Committee. During the past fiscal year, this Committee met eight times.

Members

André Bérard
Chair and ex-officio member

Léon Courville
Ex-officio member

Jean Douville

Marcel Dutil

Paul Gobeil

Bernard Lemaire

Robert Parizeau

Lino Saputo

Jean Turmel
Ex-officio member

The Chair of each of the other Committees of the Board of Directors is invited on a rotating basis.

CREDIT COMMITTEE

The Credit Committee approves the credits of clients, by borrower and by group of borrowers, which exceed the powers delegated to Bank officers. It approves any transaction between the Bank and related parties in accordance with the requirements of the Bank Act and makes recommendations thereon to the Board of Directors. This Committee ensures that changes in non-current loans are monitored and approves the taking of provisions required in that regard. It forwards to the Board of Directors the recommendations it deems appropriate concerning matters that come within its competence. During the past fiscal year, this Committee met eight times.

Members

Raymond Royer
Chair

André Bérard
Ex-officio member

Léon Courville
Ex-officio member

François Jean Coutu

Donald M. Green

J.-Robert Ouimet

Lino Saputo

The other members of the Board of Directors are invited on a rotating basis.

AUDIT COMMITTEE

The Audit Committee examines all documents containing financial information and the annual and quarterly financial statements of the Bank and certain of its subsidiaries and recommends approval thereof to the Board of Directors. It examines the mandate, nature and scope of the Bank's internal and external audit work and verifies the effectiveness of its internal control policies, systems and procedures; it ensures that internal audit personnel cooperate with the external auditors. It also ensures that the necessary measures are taken to follow up the recommendations resulting from the internal and external auditors' reports and recommends the appointment and remuneration of the Bank's external auditors. The Committee meets with external auditors and representatives of the Office of the Superintendent of Financial Institutions and takes their recommendations into consideration. During the past fiscal year, this Committee met four times.

Members

Paul-Gaston Tremblay
Chair

Paul Gobeil

Suzanne Leclair

Gaston Malette

Claude F. Savoie

CONDUCT REVIEW AND CORPORATE GOVERNANCE COMMITTEE

This Committee makes recommendations to the Board of Directors concerning the adoption of the Bank's orientations, policies and practices with respect to corporate governance and ensures that they are applied. It also assumes certain responsibilities normally assigned to a human resources committee. Lastly, it assumes the function of a conduct review committee within the meaning of the Bank Act. It consists exclusively of external directors, most of whom are unrelated directors within the meaning of the rules and corporate governance policies of the Montreal Exchange and Toronto Stock Exchange, and are not affiliated with the Bank as defined in banking regulations.

The Conduct Review and Corporate Governance Committee has three distinct roles:

- With respect to conduct review, the Committee ensures that policies and practices concerning transactions with related parties of the Bank are established and followed. The Committee also monitors the application of procedures established to resolve conflicts of interest in handling customer complaints and for disclosing information to Bank clients.
- With respect to human resources, the Committee appraises the performance of the Named Executive Officers of the Bank and submits its recommendations regarding their aggregate remuneration and other employment conditions to the Board of Directors.
- With respect to corporate governance, the Committee determines and periodically revises the criteria for selecting directors and the terms and conditions of their remuneration. It also oversees the entire disclosure process with respect to any discrepancy between the Bank's conduct in terms of corporate governance and the policy statements of the Montreal and Toronto stock exchanges.

During the past fiscal year, this Committee met six times.

Members

Paul Gobeil
Chair

Gérard Coulombe
Shirley A. Dawe
Gaston Malette
Léonce Montambault
Robert Parizeau
Michel Perron

BUSINESS DEVELOPMENT COMMITTEES

The mandate of the Business Development Committees is to help the Bank obtain a better understanding of the needs of each region and of its development potential. The members of these Committees therefore advise the Bank's regional vice-presidents on the orientations, needs, means, business opportunities and customer service in their respective regions. They contribute to the Bank's visibility, defend its interests and act at all times as Bank ambassadors.

A senior Bank officer has been assigned to liaise with each of these Committees in order to facilitate the exchange of information between the Committees and the Bank's management. In addition, each year, one of the Business Development Committees is selected as the "Business Development Committee of the Year" based on a certain number of preset criteria dealing primarily with business development.

Members

The list of members appears on pages 82 and 83.

OFFICERS

Executive Office

André Bérard
Chairman of the Board and
Chief Executive Officer

Léon Courville
President, Personal and
Commercial Bank, and
Chief Operating Officer

Jean Turmel
President, Financial Markets,
Treasury and Investment Bank

Senior Vice-Presidents

Gilles Bissonnette
Banking and Operations

Harvey L. Brooks
United States

Richard Carter
President
SIBN Inc.

Patricia Curadeau-Grou
Chair of the Credit Committee

Pierre Desbiens
Insurance

Gisèle Desrochers
Human Resources and
Administration

Jacques Grandmaison
Card Services and
Electronic Networks

Jean Houde
Banking and Retail Market

Michel Labonté
Finance and Control

Mario Lecaldare
Corporate Banking, Canada

Tony P. Meti
Banking and
Commercial Market

Réal Raymond
Senior Executive
Vice-President
Corporate Financing
Lévesque Beaubien
Geoffrion Inc.

Gaby Touma
International

Louis Vachon
Treasury and
Financial Markets

Executive Vice-Presidents

Jean-Pierre Bélanger

Pierre Desroches
Wealth Management and
President and
Chief Executive Officer
General Trust of Canada

Presidents of Subsidiaries

Yves Breton
President
National Bank Securities Inc.

Pierre Brunet
President and
Chief Executive Officer
Lévesque Beaubien
Geoffrion Inc.

Michel Tremblay
President and
Chief Operating Officer
Natcan Investment
Management Inc.

Ombudsmen

Roland Robichaud
Independent Businesses

Jean-Pierre Nobert
Consumer Services

Vice-Presidents

Dana Ades
Special Loans, Quebec/Atlantic and Real Estate

Santo Alborino
Employee Relations

Jean-Luc Alimondo
Europe/Middle East/Africa

Richard Barriault
Taxation

André Bélanger
Corporate Services
General Trust of Canada

Guy Bérard
Risk Management and Administration
Financial Markets

Pierre Blais
Government and Public Sector Banking

André Boileau
Chaudière/Appalaches

André Bolduc
National Bank Securities Inc.

Luc Bordeleau
Lower St. Lawrence/Gaspé

Michel Brouillette
Drummond/Bois-Francs

Diane Cadieux
Montérégie Sud

Jean-Marie Canuel
Eastern Townships

Jean-Paul Caron
Corporate Affairs

Linda Caty
Corporate Secretary

Gilles Choquet
Laurentians/Lanaudière

Rosaline Cyr
Ontario East and North

Jean Dagenais
Chief Accountant

France David
Audit

Philippe DesRosiers
Atlantic

Yvan Desrosiers
Saguenay/Lac Saint-Jean/North Shore

Frank De Vries
United States Division

Tom Doss
Credit, United States

Laura Dottori
Credit and Specialized Products

Lévis Doucet
Richelieu/Yamaska

Christopher Elgar
Commercial Markets
Ontario and Western Canada

Michel Faubert
Operations Support

Luc Fredette
Credit, Canada

F.W. Lynn Gallant
Greater Toronto

Francine Gaudreault
Abitibi/Témiscamingue

Michel Gendron
Commercial Banking
Montreal/Bank Tower

Richard Hébert
Mauricie

Raymond H. Keroack
North/Central Montreal

Pierrette Lacroix
Treasury, United States

Jean-Pierre Lambert
Outaouais

Natalie Larivière
SIBN

Jacques Latendresse
Nassau

Richard Leclerc
Personal Trust Services
General Trust of Canada

Réjean Lévesque
Western Montreal

Benoit Loranger
Central Montreal

Paul-André Malo
Special Projects, Real Estate

J. Archie Marshall
Central Ontario

Gilles Morin
Forest Products

Renaud Nadeau
South Shore

Martin Ouellet
Treasury and Financial Markets

Paul-André Paradis
Eastern Montreal

Denis Pellerin
International Credit and Investment

Jacques Piché
International Commercial Operations

Gérard Proulx
Laval/North Shore

John Richter
Eastern United States

Nicole Rondou
Marketing

Lili J. Shain
Corporate Banking

Vincent Sofia
Asia

John W. Swendsen
Western Canada

Marc Taillon
Sainte-Foy/Portneuf

Dominique Vachon
Chief Economist

Jacinthe Vaillancourt
Quebec City

Kathleen Zicat
Human Resources Development

BUSINESS DEVELOPMENT COMMITTEE MEMBERS

ATLANTIC CANADA

Normand Caissie
President
Imperial Sheet Metal Ltd.
Richibucto, NB

Bernard Cyr *
President
Cyr Holding Inc.
Moncton, NB

Eugène Durette
President
Brunswick Shopping Centre Ltd.
Edmundston, NB

Yvan Normandeau
General Manager
Commission d'expansion économique de la Péninsule Inc.
Tracadie-Sheila, NB

Brigitte Robichaud
Lawyer
Stewart McKelvey Stirling Scales
Moncton, NB

Jean-Claude Savoie
President
Groupe Savoie Inc.
Saint-Quentin, NB

Brigitte Sivret
Lawyer
Cabinet Brigitte Sivret
Bathurst, NB

QUEBEC

Abitibi/Témiscamingue

Jacques Aubé
President
Gabriel Aubé Inc.
La Sarre

Louis Blanchette
Malartic

Frantz Boivin
Manager
CKVD & CHOI Rock Détente
Val-d'Or

Robert Cloutier *
President and Chief Executive Officer
Gestion Montemurro Ltée
Rouyn-Noranda

Claude Gagnon
President
Corporation Zodiaque Ltée
Ville-Marie

Normand Langlois
Secretary and Treasurer
Blais & Langlois Inc.
Matagami

Guylaine Paquin
President and Chief Executive Officer
Lesage Tremblay Ultima
Rouyn-Noranda

Gilles Plante
Managing Partner
Raymond Chabot Martin Paré
Amos

Jean-Guy Roberge
Regional Vice-President
Imprimerie Québécor Lebonfon
Val-d'Or

Chaudières/Appalaches

Sandra Blanchet
Gestion Blanchet Inc.
Saint-Romuald

Richard Duval
President
Les Lainages Victor Ltée
Saint-Victor

André Gosselin
President
Entreprises Dufour & Gosselin Inc.
Quebec City

Paul-Émile Grenier *
President
Société Grenco Inc.
Thetford Mines

Pierre Létourneau
Vice-President, Finance and Administration
Équipement Labrie Ltée
Saint-Nicolas

Simon-Pierre Paré
President and Chief Executive Officer
Rousseau Métal Inc.
Saint-Jean-Port-Joli

Drummond/Bois-Francs

Guy Aubert
President and Chief Executive Officer
Thiro Ltée
Victoriaville

Alain Dumont
President
Cercueils Vic Royal Inc.
Victoriaville

Denis Forcier
Chartered Accountant
Forcier, Beaudry, Landry
Drummondville

Fernand Lallier
President and Chief Executive Officer
Imprimerie d'Asbestos (1980) Inc.
Asbestos

Claude Pépin
Sales Representative
Warwick

Jean-Luc Vigneault
President and Chief Executive Officer
Vexco Inc.
Plessisville

Eastern Townships

Gérald Bouchard
Co-Owner
Service de l'Estrie
Sherbrooke

Gilles Fontaine *
Lawyer
Fontaine, Désy
Sherbrooke

Dany Lachance
Notary
Lagassé Lachance Beaupré Poisson
Sherbrooke

Yvan Michel
Director of Administrative Services
Industries manufacturières Mégantic Inc.
Lac Mégantic

Jean Pelchat
President
Marché Jean Pelchat Inc.
Magog

Yolande Vanier
Councillor
Municipality of Rock Forest
Rock Forest

Malcolm L. Wheeler
President
Herwood Inc.
Windsor

Lanaudière

Marie Bernier
Vice-President
Imprimerie Bernier & Fils Inc.
Repentigny

Lise Charbonneau
Owner
Ferme Lise Charbonneau
Saint-Roch-de-l'Achigan

Marcel Gauthier
President and Chief Executive Officer
Centre de ski Mont-Garceau
Saint-Donat

Paul Michaud *
President
Carrière Saint-Barthélémy (1990) Ltée
Saint-Barthélémy

Diane Nicoletti
President
Maison de la Cigogne au Pierro
Joliette

Georges Saulnier
President
Les Industries Saulnier Inc.
Saint-Gabriel-de-Brandon

Laurentians

André Bolduc
Pharmacist
Pharmacie André Bolduc
Mont-Laurier

Denis David
President
Esthétique d'auto Sainte-Agathe-des-Monts Inc.
Sainte-Agathe Sud

Suzanne Fortin
Partner
Prévost, Auclair, Fortin & D'Aoust
Saint-Jérôme

François Léger
Manager
Groupe Sutton Laurentides
Saint-Sauveur-des-Monts

Chantal Rochette *
President
Au Coin du Jardin Inc.
Saint-Sauveur-des-Monts

Laval/North Shore

Pierre Belle
President
Groupe Litho Mille-Iles Ltée
Terrebonne

Denis F. Gauthier *
Lawyer
Gauthier, Dion, Avocats
Laval

Pierre Grand'Maison
President
Thermoplast Inc.
Laval

Marielle Hébert
President
ISO Concept Inc.
Laval

Edmond Lavallée
Chartered Accountant
Lavallée Hébert, C.A.
Saint-Eustache

Benoît Roy
General Manager
Intermat
Terrebonne

Lower St. Lawrence/Gaspé

Gilles Bérubé
President
Groupe Cédrico Inc.
Price

Georges Harrisson
Management Consultant
Les Habitations Mont-Carleton 1994 Inc.
Carleton

Claire Langlois
Notary and Legal Advisor
Amqui

Daniel Marquis
President
Marquis Pontiac Buick Inc.
Matane

André Racine
President
Boutique Vagabond Inc.
Rimouski

Reine-Marie Roy *
Lawyer
Gendreau, Roy, Beaulieu & Carrier
Rimouski

Renaud Samuel
President
Groupe RT
Rivière-au-Renard

Pierre Simon
Corporate Director
Notre-Dame-du-Portage

Mauricie

Fernande Boisvert
President
Secrétariat Plus (Trois-Rivières) Inc.
Trois-Rivières

Louise Gamache
Vice-President, Finance
Estampage J.P. L. Ltée
Sainte-Marthe-du-Cap-de-la-Madeleine

Raymond Mailhot
President
B.S.G. Inc.
Cap-de-la-Madeleine

Pierre Tremblay
Chairman of the Commission scolaire de Trois-Rivières
Director of Personnel
Université du Québec à Trois-Rivières
Trois-Rivières

Laurent Verreault *
Chairman of the Board, President and Chief Executive Officer
Groupe Laperrière & Verreault Inc.
Trois-Rivières

Montérégie Sud

Gilles Audette
Farm Producer
Saint-Polycarpe

Claude Boyer
Chartered Accountant
Société Bourassa Boyer, C.A.
Vaudreuil-Dorion

Clément Leblanc
Notary and Legal Advisor
Châteauguay

Yves Loiselle
President
Excavation Loiselle & frères Inc.
Saint-Timothée

Louise Montpetit *
President
Automobiles Régate Inc.
Valleyfield

Jean-Paul Régis
General Manager
Commission scolaire des Trois-Lacs
Vaudreuil-Dorion

Outaouais

André Beaudoin *
President
Slush Puppie Canada Inc.
Hull

Pierre Bergeron
Publisher and General Manager
Le Droit
Ottawa, ON

Gustave Brunet
President and
Chief Executive Officer
Sylvio Brunet & Fils Ltée
Fassett

Gilles Desjardins
President
Groupe Brigil Inc.
Gatineau

Jean-Guy Hubert
President
G. Hubert Auto Ltée
Maniwaki

Martin Lachapelle
Manager
Roger Lachapelle
Pontiac Buick G.M.
Hull

Maurice Marois
President
Marois Électrique (1980) Ltée
Hull

Robert Roy
President
Le Groupe Sotramont
Hull

Richelieu/Yamaska

Gérard Bernard
President and
Chief Executive Officer
Les Placements Robert Bernard Ltée
Saint-Paul-d'Abbotsford

Jean Cartier *
President
Emballages Jean Cartier Inc.
Saint-Césaire

Jacqueline Larochelle
Chambly

Pierrette Lussier
Granby

Claude Mayer
President
Camoguid Inc.
Saint-Théodore

Jean-Pierre Robin
President
Gestion Valentine Inc.
Saint-Hyacinthe

Réjane Salvail
Sainte-Anne-de-Sorel

Jacques Sylvestre
Partner
Sylvestre & Associés, avocats
Saint-Hyacinthe

Saguenay/Lac Saint-Jean/ North Shore

Marcel Bouchard
Owner
Auberge des 21
La Baie

Germain Deschênes
President
Hamilton & Bourassa
(1988) Enr.
Baie-Comeau

Marc-André Lévesque
Co-President
Groupe Radio Antenne 6
Roberval

Pierre Lévesque
General Manager
Gravel & Lévesque Inc.
Jonquière

Jean-Marc Maltais
President and
Chief Executive Officer
Consomat
Alma

Marlène Ouellet *
Notary
Chicoutimi

Benoît Rousseau
President
Motel Chutes des Pères Inc.
Mistassini

South Shore

Serge Beauchemin
President
3-SOFT
Brossard

Luc Lambert
General Manager
Groupe Lambert
Saint-Basile-le-Grand

Raymond Landry
President
Gestion Savoie Landry Inc.
Saint-Hubert

Jean Montpetit
Vice-President
Batteries Power (Iberville) Ltée
Iberville

Claudette Pigeon
Certified General Accountant
Varennes

Carole St-Charles *
President
J.L. Freeman Inc.
Boucherville

Pierre Trahan
President
Cédarome Canada Inc.
Brossard

Farm Committee

Michel Desjardins
Farm Producer
Montebello

Jacynthe Gagnon
Farm Producer
Sainte-Agnès

Victor Girouard
Farm Producer
Saint-Hyacinthe

Heinz Grogg
Farm Producer
Maskinongé

Pierre Joyal
Farm Producer
Les Maïs Pierre Joyal Inc.
Saint-David

Jean-Marc Lacroix
President
J.M. Lacroix & Fils
Laval

Marie-Claire Lafrenière *
President
Fédération des producteurs de volailles du Québec
Saint-Charles-de-Bellechasse

Larry Ness
Farm Producer
Terrace Bank Ayrshires
Howick

High Technology Committee

François Aird
President
CEDROM-SNi
Outremont

Robert Carrier
President
Genicom Consultants Inc.
Montreal

Richard Cormier
President
Jazz Réseau Médias
Montreal

Bernard Hamel *
President
GTI Capital
Montreal

Claude Martel
President and
Chief Executive Officer
Inno-Centre
Montreal

Claude McMaster
Partner
Arthur Andersen
Montreal

Serge Pichette
Lawyer
Bélanger Sauvé
Montreal

ONTARIO

Central Ontario (Toronto)

J.R. Alexander
President
Algonquin Group of Companies
Huntsville

John K. Macdonald
President
Armak Resilient Floor Covering Corporation
Mississauga

Marlene Oilgisser
Richmond Hill

Ted Pattenden
President
NRI Industries Inc.
Toronto

Leslie Slater
Chartered Accountant
Toronto

Claude Théberge *
Chief Executive Officer
C.M.L. Industries Ltd.
Unionville

Eastern Ontario (Ottawa)

Noël J. Berthiaume
Lawyer
Berthiaume, Perrier, Brisebois, D'Amours
Hawkesbury

John French
President and
Chief Executive Officer
Dustbane Enterprises Limited
Ottawa

Jacques Lamarche
Lefaivre

Christine Lamothe-Moir
Managing Partner
Performance Development Training
Ottawa

Richard Laplante
President
Builder's Warehouse Inc.
Orléans

Jean-Guy Rivard
President
Valecraft Homes Ltd.
Orléans

Andrew Wolff
Ottawa

Carole Workman *
Vice-Rector – Resources
University of Ottawa
Ottawa

Windsor/Essex

Fred Cowlin
President
Clydesdale Insurance Brokerage Limited
Windsor

Murray G. Cummings
President
TSC Stores Ltd.
London

John Furlan
President and
Chief Executive Officer
H.E. Vannatter Limited
Wallaceburg

Tom O'Brien
[illegible]
Automotive Leader
PricewaterhouseCoopers
Windsor

John E. Omstead *
President
Family Tradition Foods Inc.
Wheatley

Eleanor Paine
Vice-President
Capitol Theatre & Arts Centre
Windsor

Karl Richter
President
Schukra of North America Ltd.
Windsor

Jeffrey M. Slopen
Partner
Wilson, Walker, Hochberg, Slopen
Windsor

Michael G. Solcz
President and
Chief Executive Officer
Valiant Machine & Tool Inc.
Windsor

Rochelle Tepperman
Vice-President
Tepperman Furniture Appliance Electronic
Windsor

* Chair of the Committee

SUBSIDIARIES AND OFFICES ABROAD

SUBSIDIARIES

CANADA

Treasury and Securities

Lévesque Beaubien
Geoffrion Inc.
1155 Metcalfe
Montreal, Quebec H3B 4S9

NBC Clearing Services
Incorporated
1155 Metcalfe
Montreal, Quebec H3B 4S9

Natcan Investment
Management Inc.
1100 University
Montreal, Quebec H3B 2G7

Innocap Investment
Management Inc.
1100 University
Montreal, Quebec H3B 2G7

Export Financing

NatExport, a division of
Natcan Trust Company
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

NBC Export Development
Corporation Inc.
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

Information Services

SIBN Inc.
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

SIBN Calculus Inc.
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

Wealth Management

Insurance

National Bank Life Insurance
Company
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

Trust Services

General Trust of Canada
1100 University
Montreal, Quebec H3B 2G7

Natcan Trust Company
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

Discount Brokerage and
Group Savings

National Bank Securities Inc.
1100 University
Montreal, Quebec H3B 2G7

National Bank Financial Services
(Investments) Inc.
1100 University
Montreal, Quebec H3B 2G7

Municipal Securities Inc.
70 Collier Street, P. O. Box 147
Barrie, Ontario L4M 4S9

Financial Planning

National Bank Financial
Planning Inc.
600 de La Gauchetière West
Montreal, Quebec H3B 4L2

Lease Financing

Alter Moneta Corporation
101 Roland-Therrien
Suite 500
Longueuil, Quebec J4H 4B9

UNITED STATES

Natbank, National Association
4031 Oakwood Boulevard
Oakwood Plaza
Hollywood, FL 33020

National Canada Corporation
125 West 55th Street
New York, NY 10019

National Canada Finance Corp.
125 West 55th Street
New York, NY 10019

National Canada Business Corp.
125 West 55th Street
New York, NY 10019

National Canada Export
Corporation
125 West 55th Street
New York, NY 10019

BAHAMAS

National Bank of Canada
(International) Limited
Charlotte House
Charlotte Street, P. O. Box N3015
Nassau, Bahamas

BARBADOS

Natcan Insurance Company
Limited
The Business Center
Upton Road
Christ Church, Barbados

HONG KONG

Natcan Finance (Asia) Limited
Room 4001, Jardine House
1 Connaught Place, Central
Hong Kong

SINGAPORE

National Bank of Canada
(Asia) Ltd.
24 Raffles Place
#25-01 Clifford Centre
Singapore 048621

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New York, NY 10019

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Suite 1100
Chicago, IL 60606

125 West 55th Street
New York, NY 10019

Agencies
200 Galleria Parkway, Suite 800
Atlanta, GA 30339

725 South Figueroa Street
Suite 1690
Los Angeles, CA 90017

Representative Offices
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401 East Pratt Street, Suite 631
Baltimore, MD 21202

5100 Town Center Circle
Suite 430
Boca Raton, FL 33486

One Federal Street, 27th Floor
Boston, MA 02110

Empire Tower
350 Main Street, Suite 2540
Buffalo, NY 14202

Two First Union Center
Suite 2020
Charlotte, NC 28282

312 Walnut Street, Suite 1900
Cincinnati, OH 45202

One Cleveland Center
1375 East 9th Street, Suite 2430
Cleveland, OH 44114

2121 San Jacinto Street
Suite 1850
Dallas, TX 75201

One Tabor Center
1200 17th Street, Suite 2760
Denver, CO 80202

165 Madison Avenue
Suite 1610
Memphis, TN 38103

201 St. Charles Avenue
Suite 3203
New Orleans, LA 70170

One Oxford Center
301 Grant Street, Suite 3440
Pittsburgh, PA 15219-6496

Riverfront Plaza
901 East Byrd Street
Suite 1140
Richmond, VA 23219

Columbia Seafirst Center
701 Fifth Avenue
Suite 6601
Seattle, WA 98104

Post Office Plaza
50 Division Street, Suite 201
Somerville, NJ 08876

American Center
27777 Franklin Road
Suite 1570
Southfield, MI 48034

One Metropolitan Square
Suite 2980
St. Louis, MO 63102

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Chicago, IL 60606

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New York, NY 10019

Offices of National Canada Business Corp.
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Charlotte, NC 28282

One Cleveland Center
1375 East 9th Street
Suite 2350
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165 Madison Avenue
Suite 1610
Memphis, TN 38103

Post Office Plaza
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75008 Paris, France

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Seoul 110-140
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Republic of China

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1376 Nan Jing Xi Lu
Shanghai, China 200040

CORPORATE GOVERNANCE PRACTICES OF THE BANK

Sound corporate governance practices are essential to protect the interests of the shareholders of the Bank. It is important that these practices are reviewed and evaluated regularly with a view to further improving the management of the Bank and the effectiveness of the Board of Directors.

In light of these requirements, in February 1995, the Board of Directors created an ad hoc committee to review the standards and practices of the Bank with respect to corporate governance. In October 1995, the ad hoc committee submitted its recommendations to the Board of Directors which responded immediately by creating the Conduct Review and Corporate Governance Committee. This Committee was mandated by the Board of Directors to advise the directors on applying and overseeing the proposed practices as well as the measures required to ensure that the Board of Directors and its committees functioned efficiently. This Committee was also mandated to safeguard its independence from management of the Bank.

In accordance with the policy statements of the Montreal and Toronto stock exchanges, the Bank presents the following information on the Conduct Review and Corporate Governance Committee, the Board of Directors and the preferred approach as regards communications and information.

WHAT IS THE CONDUCT REVIEW AND CORPORATE GOVERNANCE COMMITTEE?

The Conduct Review and Corporate Governance Committee consists primarily of directors who are considered "unrelated directors" as defined in Policy I-15 of the Montreal Exchange and who are not "affiliated with the Bank" as defined in banking regulations (see boxes). No officer or employee of the Bank or its affiliated companies is a member of this Committee.

UNRELATED DIRECTOR

"A director who is independent of management and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interest of the company, other than interests and relationships arising from shareholding."

Montreal Exchange, *Policy I-15: Corporate Governance Disclosure*, July 1995, art. 2.

DIRECTOR NOT AFFILIATED WITH THE BANK

A director who is neither an officer or an employee of the Bank or of a corporation controlled by the Bank nor a person who, directly or through companies with whom such person is affiliated, maintains significant relations with the Bank covering a range of business or shareholding situations, as well as the spouse of such person.

Banking regulation on affiliated persons.

Pursuant to the mandate it received (see page 79), the Conduct Review and Corporate Governance Committee of the Bank has three distinct roles. It recommends to the Board of Directors the orientations, policies and practices to be adopted regarding corporate governance and ensures that they are monitored and applied. It assumes the responsibilities normally assigned to a human resources committee established according to generally accepted practices at Canadian banks with regard to the compensation of Named Executive Officers. Finally, it assumes the function of a conduct review committee within the meaning of the Bank Act.

Since November 1, 1997, the Committee has:

Corporate governance

- Examined, analyzed and followed up with the Board of Directors the main concerns expressed by shareholders of the Bank at the last Annual Meeting, with respect to corporate governance;
- Adopted a guideline under which each director must hold no less than 2,000 shares of the Bank with the goal of aligning the interest of the directors more fully with that of the shareholders;
- Studied candidacies and made recommendations with respect to the appointment of new directors in 1998;
- Studied and made recommendations concerning the composition of Board committees;
- Held information seminars for directors;
- Participated in an off-site Bank strategic planning forum jointly attended by the directors and senior officers;
- Revised and updated a handbook of corporate information for the use of the directors;
- Studied a proposal and made recommendations on the increase in the remuneration of directors of the Bank and its subsidiaries reflecting their expanded duties and responsibilities, in order to ensure that their remuneration remains competitive with current market practices;
- Examined and approved the regulatory text on the disclosure of the corporate governance practices of the Bank for insertion in the 1997 annual report;
- Reviewed various aspects of the organization and performance of the Board of Directors. After in-depth consideration and analysis of the composition of the Board of Directors and its major responsibilities, the Committee made the following recommendations in particular:
  - a gradual reduction in the years ahead in the maximum number of directors, bringing it to 20 members;
  - the Board's composition should:
    a) combine appropriate expertise;
    b) maintain a diversified geographic, economic and socio-cultural representation; and
    c) favour an increase in the number of women on the Board of Directors to at least 30% of the total number of directors;
    all in accordance with statutory requirements;
  - the successive renewal of the mandate of a director be limited to 15 years;
  - a gradual reduction in the retirement age, from 70 to 65 years of age.

Human resources

- With a view to making the organizational structure more efficient and equip the Bank with strong, shared leadership, recommended the restructuring of the senior executive level into two major segments, each headed by a president: the Personal and Commercial Bank under Léon Courville, and the Financial Markets, Treasury and Investment Bank under Jean Turmel;
- Reviewed all components of the aggregate compensation of Named Executive Officers (salary component, short-term compensation and long-term bonus program) and made a recommendation thereon to the Board of Directors, which entailed certain readjustments to take current market practices into account;
- Reviewed and finalized the Report on the Compensation of the Officers of the Bank which formed part of the 1997 Management Proxy Circular.

Conduct review

- Reviewed the policies and practices concerning the transactions of the Bank with related parties;
- Examined management's reports on transactions with related parties (directors and officers);
- Examined an internal audit report on the methods for reviewing transactions with related parties;
- Examined a report on the guidelines respecting the disclosure of information to Bank customers;
- Examined the procedures for handling customer complaints and the related statistical reports;
- Met with the two ombudsmen of the Bank (for consumer services and for independent businesses) and examined a detailed report on customer complaints;
- Approved the regulatory report to the Superintendent of Financial Institutions concerning the Committee's conduct review activities for fiscal 1998.

ROLE AND INDEPENDENCE OF THE BOARD OF DIRECTORS

The Board of Directors supervises the management of the business and internal affairs of the Bank. Directly or through its various committees (which report to the Board after each of their meetings), the Board of Directors assumes overall responsibility for overseeing and monitoring management, in particular with respect to the following:

- Description of the Bank's mission, setting of its objectives and approval of effective strategies to ensure their realization;
- Changes made from time to time to management organizational structures;
- Policies on the business and financial practices of the Bank regarding risk and internal controls as well as the annual compliance reports relating thereto;
- Credit risk management policies, including the criteria, latitudes, limits and responsibilities inherent in credit decisions;
- Compensation policies for employees and officers of the Bank;
- Planning of succession for the Bank's senior management;
- The Bank's communications policy;
- All matters for which directors are exclusively responsible under the Bank Act.

During 1998, the Board of Directors held 11 meetings. On two occasions, the Board of Directors, chaired by the Chair of the Conduct Review and Corporate Governance Committee, held part of its meeting without the officers of the Bank being present. At least one meeting of the Board each year is held in a city other than Montreal to allow directors to better understand the diversity of the regions in which the Bank operates. In 1998, the Board of Directors met in Moncton, New Brunswick.

Composition of the Board of Directors

As at October 31, 1998, 84% of the Bank's Board of Directors (namely 21 directors out of 25) were unrelated directors as defined in the guidelines of the Montreal and Toronto stock exchanges. As at the same date, 13 Bank directors were affiliated with the Bank, as defined in banking regulations. This number is within the limit of two-thirds set under the Bank Act.

Independence of the Board of Directors

Under the Bank Act, the Board of Directors is required to set up procedures to prevent and resolve conflicts of interest. It is the responsibility of the Conduct Review and Corporate Governance Committee to make recommendations to the Board in this regard, in particular by regularly reviewing the procedures to provide disclosure as they relate to conflicts of interest. The directors are required to respect these procedures, including the rules that relate to them with respect to the deliberations by the Board and its committees.

It should also be noted that the statutory responsibilities assigned to the Conduct Review and Corporate Governance Committee concerning conduct review (see the explanation of conduct review above) constitute, by their nature, additional security in terms of the independence of the Board of Directors.

The Chairman of the Board and Chief Executive Officer, the President, Personal and Commercial Bank, and Chief Operating Officer and the President, Financial Markets, Treasury and Investment Bank are the only officers who sit on the Board of Directors. The Board of Directors and the Conduct Review and Corporate Governance Committee are of the opinion that these three officers' participation in the deliberations of the Board and certain of its committees has a material impact on their efficiency and performance and is in the best interests of the Bank.

Number and representativeness of the nominees proposed for the position of director in 1999

It is important for the Board of Directors to be diversified from a geographic, economic and socio-cultural standpoint. The Conduct Review and Corporate Governance Committee acts as a nominating committee responsible for proposing candidates as director. These nominees are selected first and foremost for their integrity, sound judgement, ability to generate public confidence, availability, commitment, professional experience and competence. Their place of residence and knowledge of regional and national issues is also taken into consideration. The Bank intends to propose the election of 23 directors at the next Annual Meeting of Shareholders; each of the nominees meet the above criteria.

Future orientation

The Board of Directors must be both experienced and dynamic. In the years ahead, special consideration will continue to be given to selecting directors who understand the new challenges facing the Bank and who can help in meeting them. The synergy generated by the vision of new directors and the experience of existing directors is an invaluable asset.

COMMUNICATIONS AND INFORMATION

Communications and information are an essential component of modern corporate management. As part of its duties, the Conduct Review and Corporate Governance Committee regularly monitors the quality of information as well as internal and external communications at the Bank.

External communications

The Bank maintains ongoing communications with its shareholders of record and non-registered shareholders through General Trust of Canada and other financial intermediaries and, in particular, by means of the Annual Meeting. Moreover, shareholders may communicate with the Bank at any time by contacting the Secretary's Office, the Public Relations Department or General Trust of Canada, the Bank's Transfer Agent and Registrar. Further information in this regard is presented on page 92. The Bank also maintains relations with investors and regularly gives them the information they need.

In addition to these methods and the communications which it is required to provide to its clients by law, the Bank remains close to its clients and the public in general through its involvement in charitable, social and business activities in the community. Another means of contact with existing and potential clients is through the Bank's Business Development Committees in the regions and its Farm Advisory Committee and High Technology Committee. Further information in this regard is presented on pages 82 and 83.

Internal information and expectations of management

For the Board of Directors and its committees to function effectively, they rely on the quality of the information provided on a regular basis, on the identification and analysis of strategic options and possible choices and on the quality of the solutions recommended.

The internal information which the Bank's management submits regularly to the Board of Directors and its committees relates mainly to the following topics:

- Strategic issues;
- Business practices and strategies;
- Accounting procedures, internal controls and various risk management conditions;
- Human resources management;
- Technological development;
- Compliance with statutory and regulatory requirements.

Taking into account the activities and studies it carried out as part of its mandate in 1998 and given the quality of the follow-up done by the Board of Directors with respect to all its recommendations during the year, the Conduct Review and Corporate Governance Committee considers that the Bank meets all its obligations in this regard.

The Committee continues to fulfill its mandate in the best interests of the Bank's shareholders.

Approved by the Board of Directors of the Bank on December 17, 1998.

ANNUAL INFORMATION FORM

Incorporation

National Bank of Canada (the "Bank") is a Schedule I bank under the Bank Act. The Bank's roots date back to 1859 with the founding of the *Banque Nationale* in Quebec City. The Bank of today was formed through a series of amalgamations, notably with The Provincial Bank of Canada in 1979, with The Mercantile Bank of Canada in 1985, and with National Bank Leasing Inc., its wholly-owned subsidiary, in 1992. Its head office and principal place of business is located at the National Bank Tower, 600 de La Gauchetière West, Montreal, Quebec, Canada H3B 4L2.

Environmental issues

In order to minimize environmental risks, a few years ago the Bank implemented a procedure setting out its environmental responsibilities when granting credit and taking possession of assets. To date, the risks involved have not had a material impact on the Bank's operations.

Executive officers

The officers mentioned on pages 80 and 81 have held various management, executive or senior executive positions with the Bank during the past five years, with the exception of Santo Alborino who, from 1993 to 1998, was employed by Bank of Montreal as Senior Manager – Employee Relations; Yves Breton who, from 1991 to 1995, was employed by *Société de portefeuille du Groupe Desjardins Assurances générales* as Senior Vice-President and General Manager, in 1995, was employed by *La Survivance, compagnie mutuelle d'assurance-vie* as President and Chief Executive Officer, from 1995 to 1998, was employed by *La Confédération des caisses populaires et d'économie Desjardins du Québec* as Senior Vice-President – Markets and Advisor to the President and Chief Operating Officer, and in 1998, was employed by the Montreal Exchange as Senior Vice-President and General Manager – Markets; Linda Caty who, from 1986 to 1994, was employed by Canadian Liquid Air Ltd. as Assistant Secretary, and from 1994 to 1998, was employed by Meloche Monnex Inc. as Corporate Secretary; Pierre Desbiens who, from 1990 to 1994, was employed by Empire Financial Group as Regional Vice-President and General Manager; Gisèle Desrochers who, from 1989 to 1994, was employed by the Quebec Government as Deputy Minister – Department of Recreation, Fish and Game, as Associate Secretary General – Administrative Reform and Higher Employment, and as Deputy Minister – Department of Revenue; Luc Fredette who, from 1992 to 1996, was employed by Royal Bank of Canada as Senior Manager – Business Lending and Senior Manager – Credit, Quebec, and Deputy Manager; Michel Gendron who, from 1993 to 1998, was employed by Royal Bank of Canada as Deputy Manager – Business Banking, and Regional Manager – Business Banking; Richard Hébert who, from 1993 to 1997, was employed by Bank of Montreal as Manager – Personal and Commercial Financial

Services, and Regional Manager – Laval North Shore; Michel Tremblay who, from 1993 to 1998, was employed by ING Canada, as Senior Vice-President – Investments, and was employed by ING Investment Management, as Senior Vice-President and Managing Director; and Louis Vachon who, from 1994 to 1996, was employed by BT Bank of Canada as President and Chief Executive Officer. The directors and executive officers of the Bank, as a group, beneficially own less than 1% of the outstanding common shares of the Bank.

Properties

With respect to real estate holdings, as at October 31, 1998, the Bank owned its head office in Montreal and, for its operations, also owned 129 other buildings in Canada and leased 580 premises, including 36 abroad. The Bank's consolidated fixed assets at cost, less accumulated amortization, and excluding furniture, equipment and leasehold improvements, amounted to $173 million as at October 31, 1998. However, no independent assessment of the market value of the Bank's fixed assets was available. Information concerning the Bank's fixed assets is provided in Note 6 to the consolidated financial statements on page 57 of the Annual Report.

Additional information

The Bank undertakes to provide to any person, upon request, a copy of the Annual Information Form of the Bank, together with a copy of any document incorporated therein by reference, a copy of the annual consolidated financial statements for the year ended October 31, 1998 with the accompanying auditors' report, a copy of any subsequent quarterly financial statements, a copy of the Management Proxy Circular of the Bank in respect of its most recent Annual Meeting of Shareholders that involved the election of directors and a copy of any other document that is incorporated by reference into a preliminary short form prospectus or a short form prospectus whenever the securities of the Bank are part of a distribution. The Bank's Management Proxy Circular dated January 18, 1999, which is enclosed with the Notice of Annual Meeting of Shareholders scheduled for March 10, 1999, contains additional information such as the remuneration and indebtedness of directors and executive officers, the principal holders of Bank shares and the share options awarded. Copies of these documents may be obtained upon request from the Secretary's Office of the Bank, 600 de La Gauchetière West, Montreal, Quebec, Canada H3B 4L2.

Documents incorporated by reference

Additional items comprising the Bank's Annual Information Form are disclosed in portions of this Annual Report and are incorporated by reference as set out in the box opposite.

Item	Reference
1. Major Subsidiaries	Pages 76, 84 and 85
2. Description of Business and Competitive Conditions	Pages 10 to 19
3. General Development of the Business	Pages 2 and 3
4. Loans by Borrower Category	Page 33, Table 3.12
5. Impaired Loans	Page 35, Table 3.15, and page 56, Note 4
6. Interest on Impaired Loans	Page 37, Table 3.16
7. Provision for Credit Losses	Page 24, Table 3.4
8. Designated Countries	Page 35, Table 3.14
9. Personal, Business and Mortgage Loans	Page 22, Table 3.2, and page 47
10. Earning Assets Abroad	Page 28, Table 3.7
11. Assets Under Administration/ Management	Page 31, Table 3.11
12. Personnel	Pages 1 and 75
13. Cash Dividends and Dividend Policy	Page 92 and page 59, Note 11
14. Main Consolidated Financial Data	Pages 41, 74 and 75
15. Quarterly Results	Page 41
16. Management's Discussion and Analysis	Pages 20 to 41
17. Market for Trading Bank's Securities	Page 92
18. Directors and Officers	Pages 77 to 81

November 26, 1998

INFORMATION FOR SHAREHOLDERS AND INVESTORS

Stock exchange listings

The common shares of the Bank as well as the First Preferred Shares, Series 10, 11 and 12 are listed on the Montreal, Toronto and Vancouver stock exchanges. The ticker symbols and newspaper abbreviations for the Bank's shares listed on the Montreal, Toronto and Vancouver stock exchanges are as follows:

	Ticker Symbol	Newspaper Abbreviations: Montreal Exchange	Newspaper Abbreviations: Toronto & Vancouver Stock Exchanges
Common Shares	NA	Natl Bk	Natl Bk
First Preferred Shares			
– Series 10	NA.PR.G	Natl Bk s10	Natl Bk s10
– Series 11	NA.PR.H	Natl Bk s11	Natl Bk s11
– Series 12	NA.PR.I	Natl Bk s12	Natl Bk s12

Transfer Agent and Registrar
General Trust of Canada
1100 University
9th Floor
Montreal, Quebec
H3B 2G7
Telephone: (514) 871-7171
1-800-341-1419

National Bank of Canada Head Office
National Bank Tower
600 de La Gauchetière West
Montreal, Quebec
H3B 4L2
Telephone: (514) 394-5000
Telex: 0525181
(Nabacan Montreal)
Internet: www.nbc.ca

General Trust of Canada acts as Transfer Agent and Registrar in Montreal, Toronto, Regina, Calgary, Halifax, Saint John, Vancouver and Winnipeg.

Dividend Reinvestment and Share Purchase Plan

Under the Dividend Reinvestment and Share Purchase Plan, holders of common shares or preferred shares of the Bank may invest in common shares of the Bank without paying a commission or administration fee.

Participants in the Plan may acquire shares by reinvesting cash dividends paid on shares held by them or by making optional cash payments of a minimum of $500 per cash payment, up to $5,000 per quarter.

For additional information, contact the Registrar, General Trust of Canada, at (514) 871-7171 or 1-800-341-1419.

Direct deposit service

Shareholders of the Bank may elect to have their dividends deposited directly into the bank account of their choice by advising General Trust of Canada.

Number of shareholders

As at October 31, 1998, there were 32,902 registered holders of common shares listed with the Registrar.

Payment of dividends

Declared dividend payments for common shares are made on the 1st of February, May, August and November; for First Preferred Shares, Series 10, 11 and 12, the dividend payment date is the 15th day of the above months.

The dividend record dates for common shares are December 28, 1998, and March 25, June 23 and September 23, 1999; for First Preferred Shares, Series 10, 11 and 12, they are January 8, April 9, July 9 and October 8, 1999.

Information

For any additional information, shareholders are requested to contact the Transfer Agent and Registrar, General Trust of Canada.

Shareholders who receive more than one copy of a document, particularly of quarterly or annual reports, are requested to notify the Registrar.

Annual Meeting

The Annual Meeting of Holders of Common Shares of the Bank will be held on Wednesday, March 10, 1999, at 8:30 a.m., at The Queen Elizabeth Hotel, 900 René-Lévesque Blvd. West, Montreal, Quebec.

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MORE THAN A BANK
AN ACTIVE FORCE
Beyond its financial statements, results and corporate strategies, National Bank of Canada today defines itself as an active force serving all of society. Its wide reach and deep roots make it a vibrant presence in the community.

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